FIRA and FIRB: Canadian and Australian Policies on Foreign Direct Investment

A. E. Safarian

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FIRA AND FIRB: CANADIAN AND AUSTRALIAN POLICIES ON FOREIGN DIRECT INVESTMENT

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Preface

This comparison of Australian and Canadian policies on foreign direct investment grew out of a paper presented to an economics seminar at Brock University. I am grateful to Tom Courchene and David Conklin who encouraged me to develop it into the present study, and to two anonymous referees who made a number of helpful criticisms. The paper is part of a larger study, funded by the Social Sciences and Humanities Research Council of Canada, dealing with national policies towards foreign-controlled companies.

1
Introduction

The 1980s are witnessing a world-wide competition for investment, technical primacy, and markets. In the process, established industries are being modernized or shifted to other countries and patterns of location for newer industries are being determined. All of this is taking place in national economies that are becoming increasingly international, and that are subject to far more uncertainty than they were only a decade ago.

Multinational companies (henceforth MNEs) play an increasing role in these processes of adjustment. The foreign content of the sales, net earnings, and employment of the world's largest industrial corporations rose significantly during the 1970s (United Nations 1983, 48). There have been major changes in both the sources and the recipients of the flows of foreign direct investment (henceforth FDI) by MNEs. The stocks of such investment, which include retained earnings, have also been changing, but more slowly. Thirteen members of the Organization for Economic Co-operation and Development accounted for the great majority of the inward and outward flows in the 1970s. The United States' share of these countries' outward flows fell from 61 per cent in the early 1960s to 29 per cent in the late 1970s, while its share of inward flows rose from 3 per cent to 27 per cent. There are now a number of important home countries for MNEs, of which Canada is one. Moreover, the great bulk of the inward flows of FDI now go to a relatively few industrial countries and half-a-dozen developing countries.

Because of the magnitude of these changes, the strategies that national governments follow in dealing with MNEs are of considerable

interest. One way in which to consider the value of Canada's is to compare them with the policies of other countries. Comparisons are often made in Canada with the foreign investment and related policies for a number of developed and developing countries, but rather infrequently with Australia. International comparisons always need to be qualified in view of the variation in the circumstances of each country, but the qualifications would seem much less significant for comparisons between Canada and Australia. Both countries are relatively small and open economies with limited capacity to affect the terms of trade. Both have federal systems that involve only a small number of governments, a circumstance that facilitates bargaining and related tactics. In each country the importance of the natural resource sector has led both to conflict between the two levels of government and to problems in the growth of the manufacturing and other sectors. There are important parallels in the concerns expressed about a large degree of foreign ownership of industry in the two countries, and in policy developments.

While the degree of foreign ownership of domestic industry is higher in Canada than it is in Australia, such ownership is relatively high for both countries in terms of the experience of the more developed countries.[1] The higher foreign ownership of Canadian industry is mainly a reflection of Canada's proximity to the United States, which has been for long the major international source of direct investment capital. In the late 1970s, about 80 per cent of the stock of foreign-owned capital in Canada was of US origin. In Australia, the United States and the United Kingdom each accounted for between 30 and 35 per cent of the stock, and Japan for about 15 per cent. Some data on the foreign ownership of industry in Australia and Canada are given in Tables 1 and 2. Another difference, however, is that Canada has become an important home country for MNEs. The stock of direct investment abroad as a percentage of the stock of direct investment in Canada rose from 25 per cent in 1974 to 37 per cent in 1979 and to 54 per cent in 1983.[2] This is an extraordinary development on the outward side for a country which, until a few years ago, contained the largest foreign-owned stock of capital in the

TABLE 1
Selected data on foreign ownership and control of Australian industry

		Foreign ownership (%)	Foreign control (%)
1	Metallic minerals	50	56
	Fuel minerals	60	75
	Other minerals	17	13
	Total minerals	52	60
2	Petroleum exploration	–	74
	Other exploration	–	54
3	Food, beverages, tobacco	29	33
	Textiles	29	33
	Chemical, petroleum, coal products	66	75
	Base metal products	34	38
	Transport equipment	54	55
	Other machinery and equipment	37	42
	Miscellaneous manufactures	30	33
	Total manufactures	31	34
4	Finance companies	48	42
	General insurance	46	45
	Life insurance	37	19

NOTES: The fiscal years are 1974-5 for mining, 1975-6 for exploration, and 1972-3 for manufactures, with finance and insurance measured in or during 1973. Data are value added for mining and manufactures, expenditures for exploration, and balances outstanding or premiums in the case of finance and insurance. Foreign control refers to situations where 25 per cent or more of the equity is held by a foreign investor and an Australian investor does not have more than this. The sectors shown for manufactures are those where the highest degrees of foreign ownership and control exist at the two-digit level. Much higher degrees of foreign control result for some industries when finer classifications are used.
SOURCES: Data from various publications by the Australian Bureau of Statistics on *Foreign Ownership and Control of Manufactures* and similar studies in the other sectors shown. For minerals, see Barnett (1979) as quoted in Anderson (1984), 53, 69.

TABLE 2
Percentages of foreign ownership and control of Canadian manufacturing, petroleum and natural gas, and mining industries, year ends 1974 and 1979

	Foreign ownership		Foreign control	
	1974	1979	1974	1979
Manufacturing				
Beverages	26	35	29	37
Rubber	71	76	99	98
Textiles	28	27	34	31
Pulp and paper	56	52	47	43
Agricultural machinery[a]	64	59	63	51
Automobiles and parts	88	83	96	92
Transportation equipment, n.o.p.	44	45	57	44
Iron and steel mills	10	8	3	1
Aluminum[b]	58	58	–	–
Electrical apparatus	63	59	71	70
Chemicals	71	61	84	71
Other manufacturing	50	43	63	52
Sub-total	52	47	57	51
Petroleum and natural gas	57	48	75	53
Mining and smelting				
Smelting and refining of nonferrous native ores	37	33	24	23
Other mining	68	57	77	64
Sub-total	56	49	58	51
TOTAL	54	48	62	51

a Includes enterprises also engaged in the manufacture of other heavy equipment which tends to overstate the foreign-owned and controlled proportion of capital actually engaged in the manufacture of agricultural implements only.
b Reflects the reclassification of Alcan Aluminum Limited from American to Canadian control in 1971. Due to the size of the enterprise relative to the industry as a whole and the provisions of the Statistics Act concerning disclosure of confidential information, all capital employed in the aluminum industry has been allocated to Canadian control and compensating adjustments made to geographic detail in the category for other manufacturing.
SOURCE: Statistics Canada, *Canada's International Investment Position*, 1979 and 1980 (1984).

world, a position recently ceded to the United States. In the late 1970s the comparable figure for Australia was still only 10 per cent. This situation may be changing as a result of large direct investment abroad by Australian mining firms in the early 1980s.

It is important to emphasize that none of the developed non-socialist countries bars FDI outright, except for specified industries (Safarian 1983a). Rather, where explicit policy exists directed to MNEs, there is some combination of incentives and disincentives. Many governments are prepared to subsidize investment, including FDI, through tax, expenditure, or regulatory policies. Some are simultaneously prepared to use some or all of these policy instruments to steer foreign direct investment in an attempt to capture nationally more of the potential gains or to serve other policy objectives.

The focus in this paper will be on policies that the firms involved would consider as disincentives; that is, policies that distinguish between domestic and foreign ownership in ways that could reduce the returns to the latter. This has certainly been the emphasis in both countries over the past two decades or so as policy has developed. In neither country is the federal government likely to direct incentives solely to foreign-owned firms. In practice, of course, discretionary incentives geared to particular firms may be directed to MNEs, which are sometimes the sole or major players in a particular project. In such cases, in both federations, it is likely to be a state or a provincial government that conducts much of the negotiation with the firms, given such governments' constitutional powers in the natural resource areas in particular. We shall return to this aspect below.

This paper will discuss the policies of the two countries towards FDI, with an emphasis on the evolution of these policies over the past fifteen years. There have been some superficial similarities in the two countries' approaches to the natural resource sector, and also in the operations of the Foreign Investment Review Board in Australia and the now-defunct Foreign Investment Review Agency in Canada (henceforth FIRB and FIRA). I shall argue, however, that these approaches have differed substantially in emphasis. Australia has concentrated on the objective of increasing domestic ownership, and it has worked at the margin on new *projects* in order to promote this end. Canada, by contrast, tried until recently to achieve a much wider set of objectives, and it went much further than Australia in encouraging the actual repatriation of control of firms. The two policies have had

quite different effects. I shall examine the reasons for these different approaches and note some alternative policies that might have avoided negative side-effects or more clearly addressed the policy concerns involved.

In June 1985 Canada replaced the FIRA with Investment Canada, a step signifying an increased emphasis on attempts to attract direct investment, and, with a few exceptions, ending review of new investments. Also, early in 1985 the Government of Canada announced it would phase out many of the aspects of the energy program introduced in 1980-1, including those directed to repatriating firms that are controlled abroad. The broad agreement on objectives and instruments in Australia over time is in contrast with the differences among Canadian governments in this area.

2
An outline of Australian policies

Table 3 summarizes the history since 1939 of Australia's policy toward inward FDI. Exchange control was in effect from 1939 until 1984. It is not a primary objective of exchange controls to perform an economic review of individual instances of direct investment, but they can be used to supplement such a review. Until the late 1960s, Australia maintained an open door toward foreign investment although a few sectors were partially or wholly closed to FDI and financing institutions were established to enable Australians to participate more fully in natural resource and industrial development.

While a welcoming attitude has remained, what evolved at the end of the 1960s and in the first half of the 1970s was a policy of closing additional sectors to FDI, of assuring Australian participation in the ownership of natural resources in particular, and (in a much more limited way) of attempting to increase net economic benefit in other respects through a review process. These policies were developed somewhat hesitantly by Liberal-Country Party governments until 1972 and with much more enthusiasm and some initial confusion by a Labour Party government that fell in 1975.[3] The present form of the policies dates from legislation passed in 1976, when a Liberal-Country government was in power; however, the antecedents of this legislation may be traced to the previous government, as the Table 3 makes clear. The Labour government elected in 1983 has continued the established policies in the main.

TABLE 3
Development of federal government policies on inward direct investment in Australia

1939-84	*Exchange control* in effect, varying degrees of severity.
1942	*Broadcasting* and TV licenses limited to citizens or Australian-controlled firms.
1945	Foreign interests not to be licensed to carry on *banking* or purchase a bank, except for those already in existence. Ten per cent limit on shareholding by any one person or company, whether owned locally or abroad. Representative offices allowed for liaison purposes.
1947	*Airline* service within Australia restricted to British subjects resident in Australia.
1965-9	Overseas firms to consult with Federal Reserve Bank on plans to *borrow* in Australia (1965). For new ventures, access to loans linked to provision made for equity participation by Australians (1968). Companies allowed to raise in Australia a proportion of their total new Australian-held equity in the company, with the latter weighted on a four-to-three basis (1969). These measures ended in 1972.
1967	Establishment of Australian Resources Development Bank and (in 1970) Australian Industry Development Corporation.
1968	Foreign ownership of individual *life insurance* companies limited to 40 per cent overall, and 20 per cent for any given foreign shareholder.
1969	Government reserves the right to prevent foreign *takeovers* considered to be contrary to the national interest.
1970	Foreign ownership of two mining firms with *uranium* interests limited to 20 per cent overall and 5 per cent for individual shareholders.
1972	Companies (Foreign Takeovers) Act empowers Treasurer to prohibit takeover by *share acquisitions* if judged not to be in national interest. Interdepartmental Committee on Foreign Takeovers examines proposals where 15 per cent or more of voting stock held by a foreign person or corporation or 40 per cent or more if two or more such persons or corporations. Guidelines on criteria of national interest issued by government.
1973	Foreign purchases of *real estate* prohibited except for certain industrial or residential purchases.
1974	Foreign Investment Committee established to review, on a non-statutory basis, foreign *acquisition of assets* of Australian firms or new businesses established by foreign interests. Guidelines set for more Australian ownership and control in *mining*.
1975	*Foreign Takeovers Act* covers both share and asset acquisitions, some other forms of takeover, and increases of 15 per cent in foreign ownership even if already controlled. Interdepartmental Committee to review all of this on

	basis of revised set of criteria of national interest. New *mineral projects* to have no less than 50 per cent Australian ownership, and similar Australian participation to be encouraged in exploration. New *uranium* projects to be 100 per cent locally owned. Screening extended to non-bank financial institutions, insurance companies, and real estate.
1976	*Foreign Investment Review Board* replaces Interdepartmental Commmittee; 50 per cent Australian equity requirement extended to *agriculture, forestry, fishing, and pastoral industry;* Australian ownership in uranium lowered to 75 per cent.
1978	*'Naturalizing'* companies with 25 per cent domestic equity, a majority Australian board, and a commitment to proceed to 51 per cent Australian ownership were allowed to proceed with new projects under the 50 per cent investment guidelines for natural resources. *Uranium projects* with at least 50 per cent local equity allowed subject to some qualifications.
1983	General *tightening up* of existing procedures and criteria for takeovers, new firms, and naturalizing companies.
1983-4	Local equity limits raised for *uranium* projects. *Exchange control* requirements for direct investors removed.
1985	Foreign-controlled *trading banks* and *merchant banks* allowed. Fifty per cent foreign ownership of *stockbroking* companies allowed.

SOURCES: Sexton and Adamovich (1981, ch.2) and various government policy statements noted in the text.

THE FOREIGN INVESTMENT REVIEW BOARD

Before we consider the operations of the FIRB, it is worth noting that substantial financial deregulation occurred in the early 1980s under both Liberal-Country and Labour governments, especially the latter. In December 1983, the exchange rate was freed. Most remaining restrictions on portfolio investment abroad were removed, as were those remaining on borrowing in Australia by overseas firms. As far as direct investment was concerned, the main effect of controls in the immediately preceding years had been that new investors could not borrow in Australia to purchase shares or assets (*Economist*, 22 February 1983, 17 December 1983, 25 February 1984, and 21 July 1984).

The screening process in Australia is based on the Foreign Takeovers Act of 1976, which, as I noted above, had antecedents

dating back to 1972. However, the establishment of new foreign-controlled businesses is covered only by policy statements and guidelines, not by statute. While compliance with these guidelines is technically voluntary, the government has a number of weapons that it can use against those who try to circumvent its clearly stated policy. For example, it might withhold foreign exchange approval and export permits unless its requirements were met. What follows describes the system in effect until 1983; the few changes introduced thereafter are noted briefly in conclusion.

The Treasury Department bears the main responsibility for policy and operation in the area of foreign investment.[4] Its pre-eminence in this field may explain the relative consistency of policy despite changes in government and despite some experimentation, particularly in the early 1970s. The Treasury's Foreign Investment Division makes its recommendation on each application to the FIRB, an administrative agency not mentioned in the Foreign Takeovers Act. The FIRB, in turn, acts as the primary source of advice to the minister. The FIRB has two part-time members (including the chairman), which are recruited from the business community, and a full-time executive member, who heads the Foreign Investment Division. Perhaps half of the cases that come before the FIRB involve routine situations in real estate and other sectors where allowance is indicated; such cases are, in effect, decided by the executive member, while the remaining cases are decided by the board in its weekly meetings. All departments and agencies that have a policy interest see each proposal before the FIRB recommends it to the Treasurer. The act does not require consultation with the state governments, but in practice the states are consulted on relevant and non-routine cases. It is rare for cases to go to cabinet, although the Treasurer does consult the prime minister and other ministers directly on major or sensitive cases.

Once the Treasurer receives notice of a takeover proposal, he has 30 days in which to issue a final order or an interim 90-day order, plus 10 days in each case for publication in the *Gazette*, or a maximum of 140 days in total.[5] Approval of some major natural resource projects has taken longer than this.

The screening process covers takeovers from abroad and within Australia, new direct investment, expansion into new lines of business, and proposals by single or associated foreign interests to

increase an equity holding by 15 per cent or more even where control has not changed.[6] 'Offshore takeovers', where a parent company abroad is acquired by another firm abroad, are reviewable with respect to the Australian subsidiary, but in this case the national interest criterion noted below does not normally apply. It should be noted that real estate transactions are subject to review, in contrast with the situation in Canada. The concerns here were to limit foreign investment in rural land (such investment is allowed only if the case for it is strong), to prevent rapid increases in the price of housing through speculation, and to assure Australian participation in major property development. For most new businesses, no review is undertaken unless the investment amounts to Australian $5 million or more; however, notice must be given of all proposals for new businesses in certain restricted sectors. Notice must also be given of all takeovers, although in most cases no action is taken if the amount involved in the takeover is under Australian $2 million. In addition, notice must be given of all real estate transactions amounting to Australian $350,000 or more. Until 1978, the limits were Australian $1 million in the first two cases and $250,000 in the third.

In order to prohibit an investment, the Treasurer must decide that it is 'contrary to the national interest'. What constitutes 'the national interest' is not spelled out in the legislation, but policy statements have been issued that convert this formula into a test of the potential net economic benefit for Australia if a given proposal is approved. A summary of the criteria used is given in Table 4. The evaluation process has two stages. The first involves a necessary condition of net economic benefit in relation to the competition and other effects noted in part (a) of the table. If the proposal is not contrary to the national interest in these terms, then additional criteria are applied as noted in part (b).

It may appear to be extremely difficult to evaluate a proposal in these terms, given the complexity of the issues and the time frame involved. The actual decision-making process has been greatly simplified in two ways, apart from the fact that many cases are regarded as routine and handled accordingly. First, an attempt is made to look at the key variable or variables in given cases, such as the taxation issue in some export cases or the effects on competition in an industry in others. No attempt is made, at least explicitly, to assign weights or priorities to all of the variables noted in some

TABLE 4
Criteria for examination of proposals, Australia

(a) Whether, against the background of existing circumstances in the relevant industry, the proposal would produce, either directly or indirectly, net economic benefits to Australia in relation to the following matters:

- competition, price levels, and efficiency;
- introduction of technology or managerial or workforce skills new to Australia;
- improvement in the industrial or commercial structure of the economy, or in the quality and variety of goods and services available in Australia; and
- development of or access to new export markets.

If a proposal is judged to be not contrary to the national interest on the basis of the above criteria, the following additional criteria are taken into account:

(b) whether the business or project concerned could be expected to be conducted in a manner consistent with Australia's best interests in matters such as

- local processing of materials and the utilization of Australian components and services;
- involvement of Australians on policy-making boards of businesses;
- research and development;
- royalty, licensing, and patent arrangements; and
- industrial relations and employment opportunities;

(c) whether the proposal would be in conformity with other government economic and industrial policies and with the broad objectives of national policies concerned with such matters as Australia's defence and security, Aboriginal interests, decentralization and the environment, as well as with Australia's obligations under international treaties;

(d) the extent to which Australian equity participation has been sought and of the level of Australian management and control following implementation of the proposal;

(e) taxation considerations (including the manner in which the proposal is to be financed);

(f) the interests of Australian shareholders, employees, creditors, and policy holders affected by the proposal.

Foreign investment proposals do not have to satisfy all of the examination criteria listed above in order to warrant approval. The list is drawn upon to the extent appropriate to the circumstances of each proposal and the importance of each criterion; and the extent to which proposals are required to meet the criteria varies from case to case.

TABLE 4 (continued)

Where proposals concern areas of the economy in which foreign ownership and control are already extensive or would become extensive as a result of their implementation, the government expects the proposals to provide for significant economic benefits and/or significant Australian equity participation before approval is granted. Special requirements and guidelines apply to proposed foreign investment in the natural resources sector and in real estate, finance and insurance, the media, and civil aviation.

SOURCE: Australia, Department of Treasury (1982) 6-7.

standardized way from case to case. More important, the examination process has been simplified by the fact that the key tradeoff between ownership and other benefits has been defined. Like many other countries, Australia is highly receptive to new investments, although some sectors are closed and there are some Australian participation requirements (which are noted below). Since new investments, unlike takeovers, do not mean the loss of domestic control of existing firms, the attitude to new investments is that there is a *prima facie* case for benefits. In takeover situations, by contrast, the view is that there should be other benefits to compensate for the loss of Australian ownership and control. Should the FIRB judge these other benefits to be low, it will recommend the retention of some measure of Australian ownership. If the benefits are high, or if the foreign firm faces problems in revealing proprietary technologies or information, the FIRB will agree to full foreign equity ownership.

The FIRB is prepared to accept the view that in high technology industries and in the case of MNEs whose international operations are highly integrated it is necessary to grant full foreign ownership in order to protect proprietary rights and the related organizational structure. The exceptions for both new and takeover investments are important, and in both cases these exceptions relate to the emphasis on Australian ownership in some sectors. First, certain sectors are closed in part or whole to foreign investors. Second, there is a requirement of 50 per cent Australian participation in new resource projects; in certain circumstances, Australian participation is also required in finance, insurance, real estate, and rural properties. Third, where foreign ownership of an industry is already high, the firm is expected either to show large other benefits or to agree to Australian participation.

A clear policy had evolved in the natural resource sector by the mid-1970s, although concern about Australian participation and some *ad hoc* policy had emerged long before then. In the areas of minerals, agriculture, fishing, and forestry, Australian policy requires that all but the smallest new projects involving foreign ownership (a) be determined not to be against the national interest and (b) generally have at least 50 per cent both in Australian equity and in Australian voting strength on the board. The latter requirements are waived if the lack of Australian capital could seriously delay development, but efforts have to be made to assure the future achievement of the 50 per cent objectives. Australian participation is not required for exploration activities, although it is actively encouraged; at the development stage, the requirements just noted for Australian participation come into effect. Uranium projects require 75 per cent domestic equity and control, although 50 per cent may be permitted in some cases.

One point to note is that approval is for new *projects*. To this extent, in contrast to the situation in Canada, the activities of existing foreign-owned firms in their usual lines of business are subject to review. The FIRB has noted that 32 of the 55 new natural resource projects that came before it from 1976 to 1982 provided for at least the minimum guideline level of Australian equity, and 20 more were required to provide for it as a condition of approval. Four of the 20 later met the guideline or had clear plans to sell equity, while 8 were required to meet the guideline before they started production 'or as soon thereafter as possible' (Australia, *FIRB Report* 1982, 67). It is evident that the FIRB, while pressing for adherence to the guideline, also

> recognizes that efforts made to satisfy the 50% guideline and the timing of entry of Australian participants will depend on the commercial feasibility of a change in equity structure – to both the foreign and the potential Australian participants. (ibid.)

In 1978, an additional approach was introduced as a result of negotiations between Conzinc Riotinto of Australia Limited and the Australian government. Briefly, 'naturalized' and 'naturalizing' companies can go ahead with new projects, other than projects in

defined key sectors, on their own or in partnership with similar firms or with Australian companies, providing the 'resultant mix' reaches the 50 per cent equity level where applicable. The Foreign Takeovers Act still applies, however. A naturalized foreign investor has at least 51 per cent Australian ownership and a board with a majority of Australians, while naturalizing investors have at least 25 per cent Australian equity and a board with an Australian majority; moreover, they have made a public commitment, which is subject to regular review, to proceed to 51 per cent Australian ownership. This type of phased ownership is voluntary. Until 1981, fewer than ten firms had opted for it, including several large ones (Australia, Department of Treasury 1982, 9-11). The lack of a fixed date for achieving the 51 per cent figure is one feature of this arrangement that has attracted criticism (Anderson 1984, 97-8).

Just how Australian participation is to be achieved beyond the natural resource sector and the others noted above is not entirely clear. In Canada, the FIRA did not formally publish private takeover offers, although the business grapevine often spread the information quickly.[7] In 1980, the Liberal government of Canada announced its intention to require that all takeover bids, public or private, be publicized and that competing bids from Canadian owners be subsidized – plans that were withdrawn in response to the furor over the National Energy Program. In France, the relevant departments search for competing domestic offers more or less routinely when significant foreign takeover bids emerge. The Australian policy, as described in some detail in the FIRB's reports for 1982 (41-5) and 1983 (14-15) is far less systematic than either of these approaches, but it does have some structure. It is customary to ask those involved in a foreign takeover bid to announce their proposals publicly, something that is not normally done in a private takeover offer. The announcement is solicited early enough in the discussions with the FIRB to allow interested Australian parties to make a bid and interested third parties to express their concerns. A public announcement is not expected in the case of takeovers involving less than Australian $2 million. The same procedure is followed in the case of a proposed property, where some care is taken to assure that Australians are given an adequate opportunity to purchase before the foreign acquisition is approved.

It is not difficult to envisage the problems that such an approach raises: in effect, the government and the FIRB determine the division of property rights among the vendor and one or more domestic or foreign bidders. In the circumstances, some ambivalence in policy is inevitable. The FIRB appears to have attempted to resolve the problems involved in such situations by concentrating its attention on only the more significant cases and by being prepared to give much weight to arguments about normal commercial considerations. Particular attention is paid to sectors in which foreign ownership is already large, and to those in which Australian equity guidelines or other restrictions apply. The FIRB also attempts to avoid appearing to negotiate for one party or the other.[8]

In general, the policy of the Australian government and the operation of the FIRB during the period from 1976 to 1983 was reasonably stable and reasonably clear, allowing for some vagueness in the area of takeovers. It was a policy that favoured direct investment, except in certain sectors and subject to Australian participation in natural resource development and a few other areas. There is considerable evidence to support this view of the Australian approach – quite apart from the policy statements emphasizing it, which have to be discounted to some degree given the ambivalence in government attitudes towards direct investment (Australia, *FIRB Report* 1982, Attachments A and C). Three points in particular may be noted.

One piece of evidence is the fact that in the years 1976-83 only about one-third of the approved applications had conditions attached to them (see Table 5). Moreover, in the great majority of cases these conditions referred to equity participation by Australians (notably in minerals), resale of an acquisition (mainly in real estate), or taxation agreements; or they drew attention to the participation requirements that would apply should exploration lead to development (see Table 6). Consultation and reporting conditions also tended to be follow-through on such matters as equity participation and taxation. These conditions should not be confused, therefore, with the undertakings on employment, foreign trade, research, and other aspects of economic performance imposed by some other screening agencies, including the FIRA.[9]

As for the monitoring process, it should be noted that conditional approvals are not part of the Foreign Takeovers Act and that the prac-

TABLE 5
Conditional approvals and rejections of foreign investment proposals, Australia, 1976-7 to 1982-3

Type of Proposal	1976-77[a]	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	Total
Approved without conditions	692	764	591	757	710	847	800	5,161
Conditionally approved	450	312	287	329	462	362	310	2,512
Total approved	1,142	1,076	878	1,086	1,172	1,209	1,110	7,673
Rejected	7	9	6	20	40	47	60	189
Total decided	1,149	1,085	884	1,106	1,212	1,256	1,170	7,862
Not requiring approval under Act or policy	252	228	168	360	447	140	108	1,703
Withdrawn	58	29	24	51	74	77	85	398
As % of total decided								
Conditionally approved	39.2	28.8	32.5	29.7	38.1	28.9	26.5	32.0
Rejected	0.6	0.8	0.7	1.8	3.3	3.7	5.1	2.4
Withdrawn	5.0	2.7	2.7	5.1	6.1	6.1	7.3	5.1

a 1 April 1976 to 30 June 1977.
NOTE: In 1981-2 and 1982-3 there were 272 and 218 proposals respectively for urban real estate and rural land together.
SOURCE: Australia, *FIRB Reports* 1982, 82, and 1983, 45.

tice of screening new businesses is based on a policy statement rather than on legislation. Thus there is no legal basis for conditional approvals, although the government has established a number of policy guidelines and ways to enforce them, as I noted earlier. In order to enforce its conditions, the FIRB relies on formal reporting in connection with matters such as major equity participation by Australians, publicity, and encouragement to firms to report major subsequent developments to the FIRB. It is important to underline, therefore, that there is no intention either to exact detailed undertakings on various aspects of economic performance or to monitor their subsequent achievement, as is the case in Canada.[10] The economic benefits claimed by the firms on entry, and considered

TABLE 6
Conditions applied to approved foreign investment proposals, Australia, 1977-8 to 1982-3

	Real estate (1978 and 1979)	Mineral exploration (1977-82)	Acquisition (includes real estate 1980-3)	New business	Total
Number of conditionally approved proposals	155	451	1,319	145	2,070
Conditions					
Resale	144	5	507	4	660
Australian equity	2	449	306	71	828
Taxation	–	1	329	32	362
Periodic reporting	70	5	399	52	526
Consultation	15	7	161	32	215
Development and zoning	24	6	69	43	142
Environment	10	9	42	22	83
Other	2	6	97	34	139

NOTES: Data for 1976-7 are not included since the classification system was more limited then. Taxation was not a separate category in 1977-8 and 1978-9. Real estate covers 1977-8 and 1978-9, since data were not shown separately for later years. Many proposals have more than one condition attached.
SOURCE: Compiled from Australia (various years) *FIRB Reports*.

and published by the FIRB, are not generally reported or enforced later.

Further evidence that Australian policy was reasonably stable and favoured direct investment is the fact that the rejection rate for the period since the FIRB began operations is only 2 per cent, having risen from less than 1 per cent in the first three years of operation to between 2 per cent and 4 per cent in later years and to 5 per cent in 1982-3. Withdrawals of applications amounted to 5 per cent of the total number of proposals; the annual figure varied between 3 per cent and 7 per cent. Withdrawals were made for a wide variety of reasons, but some portion certainly reflected a recognition that the proposal would be rejected unless it was modified to meet government policies. It is important to note that private parties often engage in extensive discussion with FIRB officers before they submit a formal proposal, in order to ascertain what is likely to be acceptable; moreover, in the course of examining formal proposals, the FIRB often suggests

modifications or conditions that lead to acceptance of proposals that would otherwise be rejected. While these considerations must be taken into account in any assessment of rejection rates, it is nevertheless interesting to note the small size of formal rejections under a system, like Canada's but unlike those in some other countries, in which the authorities are not attempting to avoid outright rejection altogether.

A number of other factors support the view that policy in 1976-83 was both reasonably stable and quite favourable towards direct investment. The FIRB and its support group had only 35 professional employees and 15 others in the later years of this period, a rather small staff given the caseload involved. At various times when the structure or the responsibilities of the FIRB might have changed significantly, the government clearly chose to avoid such changes. The decision not to have a register of foreign investment proposals is a case in point.

This measure had been promised in the 1976 guidelines, but on the advice of the FIRB it was never instituted. The government also avoided a plausible opportunity to change its approach when it decided not to issue a more detailed set of economic guidelines; the FIRB argued that the adherence to the OECD guidelines for MNEs eliminated any need for such a step (Harvey 1981, 179-84).[11] A review completed by the government in 1982 left the main features of the FIRB unchanged (Australia, *FIRB Report* 1982, Attachment C).

If Australian policy toward inward direct investment was both generally favourable and reasonably stable between 1976 and 1983, it does not follow that this policy was consistent or free of conflict. Harvey (1981) and Sexton and Adamovich (1981) have underlined the lack of a legal basis for new investment regulation, the weak enforcement process, and uncertainty about some aspects of policy. Long delays in approving major resource projects occurred at times; environmental control considerations provided one reason for these delays, but they were also caused by efforts to ensure 50 per cent Australian ownership.[12] In 1981, the Treasurer pressed Shell Australia to sell 25 per cent of the equity in the existing *firm*, a move quite distinct from the policy of 50 per cent participation in new *projects;* however, upon running into objections, the Treasurer did not push ahead with his proposal. I shall consider some of the ways in which the policy position conflicted with other objectives in Chapter 4.

In concluding this section, a few comments are in order about Australian policy on outward direct investment.[13] As I noted earlier, Australia is not a substantial exporter of capital. During the 1976-83 period, the policies with the largest effect on capital export were those related to exchange control. Approval for capital export was given if the investment involved Australian managerial participation and export of skills, promoted Australian exports, or protected an existing investment abroad. These criteria were designed to test whether a direct investment rather than a portfolio investment was involved; portfolio investments were limited by exchange control. Trade considerations also played a part in determining policy towards capital export, as is shown by the second of the above criteria and by the government's unfavourable view of direct investments set up outside Australia for the purpose of promoting exports to Australia. Investments by financial enterprises abroad were scrutinized closely to assure that the controls on foreign borrowing in Australia were not evaded. Current income could be retained abroad provided it was demonstrated that this income was needed for development purposes. There was no attempt, however, to evaluate the broader economic effects on Australia of outward direct investment, including the question of whether the firm might be able to export instead. The few rejections of applications in recent years have been related to questions about whether a direct investment was actually involved.

RECENT DEVELOPMENTS IN AUSTRALIAN POLICY

The election of a Labour Party government in March 1983 might have been expected to change the situation significantly. Before Labour formed the government, its position on the regulation of MNEs had certainly been stronger than the policies in effect in 1976-83, despite the fact that most of the important aspects of that policy, which had evolved in the mid-1970s, incorporated changes introduced by the previous Labour government and enjoyed the support of the major parties. In the election campaign of 1983, the Labour Party called for the following measures (*Economist*, 25 February 1983, 74):

– a requirement of at least 50 per cent Australian participation not only in new mineral projects, as before, but also in new investments in other industries;

- stronger efforts to assure 50 per cent local ownership in new mineral projects, including government participation in some cases; a reversal of the Fraser government's decision to license up to ten foreign-owned banks;
- the restoration of higher domestic ownership ratios in uranium;
- stronger controls on foreign investment in rural and urban land.

To date, however, the Labour government under Prime Minister Bob Hawke has stopped well short of implementing these proposals. A review of foreign investment policy left the main elements of the existing policies unchanged, while underlining both the 'significant contribution' that foreign capital can make and the need to assure Australian participation in development. In particular, the government 'decided that it would not be appropriate or desirable to establish specific Australian equity guidelines for all sectors of the economy, nor to require majority Australian equity for new projects or businesses' (in sectors other than those in which this policy was already in effect). In other respects, some tightening up of the existing provisions is evident. For example, the FIRB rejected some proposed mergers that might have been approved earlier and allowed fewer deferrals of compliance with the 50 per cent participation rule.[14] The criteria for examining foreign investment proposals have been extended to include opportunities for Australian contractors and consultants to engage in construction, the introduction and diffusion of new technology and other skills, and limitations on export franchises. These additions were at least implicit in the existing criteria (Table 4, [a] and [b]). A timetable for naturalization was to be worked out in consultation with the companies involved, and the government announced that two additional members, including a trade unionist, were to be appointed to the FIRB. It was also emphasized that the FIRB was to 'continue to provide to the Government an independent and business oriented source of advice.'[15]

The previous Labour government had required 100 per cent Australian ownership of mining and primary production of uranium. This figure was reduced first to 75 per cent and later, in some cases, to 50 per cent by the succeeding governments. The present Labour government has announced that it will raise the requirement to 75 per cent for deposits discovered before 1977 and to 100 per cent for later

finds. The government also has been under pressure from the Labour party to terminate a supply contract with France, which has been conducting nuclear tests in the Pacific (*Economist*, 7 May 1983, 74-5; 21 July 1984, 61).

The Campbell Committee recommended in 1981 that foreign commercial banks be allowed entry, in contradiction to long-standing policy. The committee's position was opposed by both the Treasury and the Reserve Bank because of concerns about the effects the entry of foreign banks would have on the management of monetary policy. The Campbell Committee also recommended that many aspects of the financial system, domestic and external, be deregulated. The Fraser government announced in January 1983 that it would issue up to ten new foreign commercial bank licenses, subject to certain conditions. One condition was a limitation on the share of foreign ownership, although local equity of less than 50 per cent would be acceptable if net economic benefits could be demonstrated. The Martin report to the Labour government agreed that more foreign commercial banks should be allowed entry but suggested a limit of four to six such banks, with foreign participation in each bank limited to a 50 per cent share. Despite the opposition of some segments of the Labour Party, the government has issued trading-bank licenses for 16 such banks, subject to varying conditions on services and ownership. Nine of the banks have no local equity, while three others have agreed to accept local participation of less than 50 per cent. In view of changes in the competitive and regulatory environments, the government has also waived for one year the rules requiring Australian participation in, and substantial economic benefits from, both existing and new merchant banks. Canada, by contrast, does not demand local equity for the roughly 60 commercial bank licenses which it has issued, although it does set a limit on the share of total assets that foreign-controlled banks can have.[16]

Early in 1984 the Australian Associated Stock Exchanges amended their rules to allow member firms to incorporate, and also to allow 'outside interests', foreign or Australian, to acquire up to 50 per cent ownership. From April 1987, the exchanges will allow up to 100 per cent outside ownership of member firms. At first the government applied the Foreign Takeovers Act, but in December 1984 it applied the maximum 50 per cent foreign ownership rule to acquisitions in this industry.[17]

The proposal by the present government to tax resource rents more fully will be discussed later in this paper.

The above discussion suggests that policy on FDI in Australia has been reasonably stable since 1975 and also reasonably clear in its objectives. It has consisted essentially in acceptance of the view that Australia needs such investment and can secure significant benefits from it. There are, however, a (declining) number of partly or wholly closed sectors and a policy of assuring Australian participation in new primary resource projects and, in certain circumstances, in several other sectors as well. Bargaining with firms to increase net economic returns on establishment or subsequent merger is certainly in evidence, but, beyond the Australian participation rules, the process tends to concentrate on very few issues or sensitive cases. Dissenting voices have been heard for some time, as will be noted later, and a burst of legislation and new proposals in 1972-5 promised to carry policy much further. The mainstream of thinking and policy since then has stopped well short of what has been attempted in Canada.

3
A comparison of Australian and Canadian policies

The balance of this study will concentrate on the Foreign Investment Review Agency (FIRA) and the National Energy Program (NEP), which have probably been the dominant Canadian policy instruments related to FDI over the past decade. It is well to note, however, that the government announced early in 1985 that it would begin to phase out much of the NEP. Moreover, on 30 June 1985 the Investment Canada Act came into force. This legislation has a purpose significantly different from that of the Foreign Investment Review Act, which it replaces. These changes are discussed later in the chapter. What follows is essentially an analysis of the system in effect over the past decade or so, rather than the regime that was being put into effect in Canada as this study was completed.

It is also well to note that a considerable number of other Canadian policies related to investment have developed over the past three decades or so.[18] Various attempts have been made, for example, to increase Canadian capacities to undertake more investment, attempts often linked in part to desires to increase the degree of domestic (or to limit the degree of foreign) ownership and control. Examples of such policies are the dividend tax credits, the limitations on investment abroad by pension funds, the easing of equity investment rules for various types of financial institutions, and the establishment of the Canada Development Corporation and Petro-Canada.

Like Australia and most other countries, Canada maintains a number of measures that seek to reduce foreign ownership and control directly, by partly or wholly closing certain sectors to foreign investors. At the federal level, there are limitations on the foreign

ownership of companies in broadcasting, newspapers, and insurance, on trust and loan companies, and on the size and growth of the foreign-owned bank sector, among other industries. The provinces have ownership policies for book and magazine distribution (Ontario and Quebec), transportation companies (Ontario), financial sectors under provincial jurisdiction, and access to public or private land (most provinces). Canada has also attempted to block the extension of foreign (mostly US) law and policy to Canada through the medium of subsidiary firms, most recently by amendments to competition legislation.

THE FOREIGN INVESTMENT REVIEW AGENCY AND THE NATIONAL ENERGY PROGRAM

Again, the major policy instruments used to regulate investment in Canada over the past decade (with the possible exception of the general tax provisions vis-à-vis the United States) have been the Foreign Investment Review Act, which created the FIRA, and the legislation that constitutes the NEP.[19] The FIRA was brought into being in 1974 and made responsible to the Minister of Industry, Trade and Commerce. It advised the minister, who reported to the cabinet on all reviewable applications for FDI. In addition to interdepartmental consultation, every application was submitted to the relevant province(s) for an opinion. Review was necessary for all acquisitions and for every establishment of a new business in Canada by foreign-controlled entities except in the cases of (a) an acquired business in a field related to that of an established Canadian business of the acquiror with gross assets not exceeding $250,000 and gross revenues not exceeding $3 million (these limits were raised in 1982 as noted below) and (b) a new business in a field related to that of an established Canadian business. The FIRA did not review the major activity of foreign-owned firms – that is, their expansion in existing lines of business – except when mergers occurred involving sums beyond the limits noted or when ownership of the foreign parent company changed. The application passed automatically after 60 days unless it was denied by the cabinet. A request for further representations could prolong the review period without limit. In the late 1970s, the average number of days required to process cases under the standard procedure, which applied to businesses not in the

small business category, varied from 80 in 1977 to 120 in 1979 (Schultz et al. 1980, 65).

To obtain approval, the investor had to satisfy the government that the investment would be of significant benefit to Canada. The FIRA was required to monitor the detailed undertakings provided by the investors in their applications. Some undertakings were renegotiated as a result of the monitoring process, but no prosecutions were launched for failure to comply with them. Significant benefit was determined on the basis of five factors specified in the act:

1 The effect of the investment on the level and nature of economic activity in Canada, including employment, resource processing, domestic sourcing, and exports.

2 The degree and significance of Canadian participation in the business enterprise and in the industry sector to which the enterprise belonged.

3 The effect on productivity, industrial efficiency, technological development, innovation, and product variety in Canada.

4 The effect on competition in Canada.

5 The compatibility of the investment with national industrial and economic policies, taking into consideration the industrial and economic policy objectives of the province(s) likely to be significantly affected by the investment.

In 1982-3, the FIRA's operations were substantially modified in order to clarify the bases of its decisions and simplify and speed up its procedures. For example, a short-form procedure had been instituted in 1977 to speed up smaller investment proposals; in 1982, the ceilings for these proposals were raised to $5 million and 200 employees for acquisitions and new business proposals, and three times that size where the control of the foreign parent had changed.[20] The rejection rate fell sharply, as noted in Table 7.

The provinces of Canada have jurisdiction over the management of natural resources in their public domains. Over time, they have developed various forms of public ownership of, participation in, and regulation of such resources. During the 1970s, the federal government intervened extensively in the energy markets, establish-

TABLE 7

Rate of allowance of foreign investment proposals, Canada, 1975-1984[a]

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1975-84
Reviewable new cases and carryover	150	228	493	727	838	963	897	1,050	1,218	1,112	6,203
Applications resolved	92	159	398	602	659	797	586	719	1,079	961	6,052
Allowed	63	114	319	541	576	687	448	513	924	585	5,043
Disallowed	12	22	33	25	44	58	63	81	60	27	425
Withdrawn	17	23	46	36	39	52	75	125	95	76	584
Carried over	58	69	95	125	179	166	311	331	139	151	-
Per cent of those resolved											
Disallowed	13.0	13.8	8.3	4.2	6.7	7.3	10.8	11.3	5.6	2.8	7.0
Withdrawn	18.5	14.5	11.6	6.7	5.9	6.5	12.8	17.4	12.9	15.7	9.6
Per cent disallowed for											
New business	*b*	0.0	6.8	4.2	5.6	7.1	9.2	11.1	8.4	4.5	7.1
Acquisitions	13.0	14.4	9.9	4.2	7.7	7.5	12.3	11.5	2.5	1.1	6.9

a Fiscal years ending 31 March for the year shown.

b New businesses were reviewed beginning on 15 October 1975.

SOURCE: Canada (various years) Foreign Investment Review Act, *Annual Reports*.

ing a public corporation, Petro-Canada, and a considerable regulatory presence with respect to pricing and supply. The National Energy Program of 1980-81, which embodied a variety of tax, expenditure, and regulatory objectives, was the culmination of these efforts. One objective of the NEP was a substantial increase in Canadian ownership and control of oil and gas revenues. The proposed increase in Canadian ownership from 30 per cent to 50 per cent by 1990 was to be achieved in part by expanding the publicly owned sector, using the proceeds of a special energy tax to buy some MNE assets.[21] A system of incentive grants for exploration and development replaced the tax allowances for depletion formerly in use. Such incentive grants were geared to the degree of Canadian ownership of the company. There had to be 50 per cent Canadian ownership at the production stage in the case of federal lands. Finally, there was a provision for a 25 per cent Crown interest in petroleum rights on federal lands, with some payment for work done to date: this provision applied also to private Canadian interests.

In mid-1985, the government replaced the FIRA with a new agency and also began to phase out all of the NEP policies noted above except the requirement for 50 per cent Canadian ownership at the production stage on federal lands.

SOME COMPARISONS

The Australian and the Canadian approaches to screening and to resources policy up to mid-1985 can be compared on the basis of three factors: organization and coverage, economic performance, and ownership and control.

Organization and coverage

There were important similarities between Australia's FIRB and Canada's now-defunct FIRA. Each agency was a specific organization with its own staff and a significant basis in law (which was more complete for the FIRA, however, especially in respect to new investments). Both published a considerable amount of information, including the broad criteria for examination of proposals. In these respects, the Canadian and Australian approaches stood in contrast with foreign investment review procedures in other developed countries (Safarian 1983a).

The differences between the agencies were also quite striking. In Australia it is the treasury minister who, after consultation, makes the ultimate decision, except in certain important or sensitive cases. In Canada, all cases that came within the jurisdiction of the FIRA were, in principle, reviewed by the cabinet; however, small business cases, which were the great majority, were reviewed by a special committee of the cabinet.

The FIRB covers a broader area than the FIRA covered. Thus the FIRA did not cover smaller real estate and rural land in the sense in which they are covered by the FIRB. (As noted above, however, some provinces restrict land purchases by foreigners or by non-residents of the province.) Moreover, an increase of existing foreign ownership beyond 15 per cent would be reviewable in Australia even when control was unchanged, but this was not generally the case in Canada. Neither the FIRB nor the FIRA reviewed the major activity of firms, expansion of their customary lines of business, provided takeover was not involved. However, while leaving the firm intact, the FIRB does have an influence on such expansion by requiring 50 per cent Australian participation in new natural resource projects and some other sectors.

The FIRB has a much more limited and more clearly defined set of objectives than did the FIRA. The focus of the FIRB is to secure domestic participation in ownership and on boards of directors in the resource sector and a few others. The focus of the FIRA was to assure, and if necessary to bargain for, improved economic performance in a wide range of areas, of which domestic ownership was only one. This fundamental difference accounted for many other differences between the two agencies: thus the FIRA's staff was larger than that of the FIRB, the legal costs of dealing with it were also larger, and its monitoring and enforcement features were stronger.[22] The difference in basic focus also helps to account for the very different perception of the two agencies by investors and by foreign governments.

Economic performance

Although the Australian criteria for judging foreign investment noted in Table 4 bear some similarity to those maintained by the FIRA, the Canadian system was quite different in the way in which it used a review process to improve economic performance. The FIRB has focused on the achievement of Australian ownership in new natural

resource projects and some other sectors, on limiting increases in foreign ownership where such ownership was already high, and on enforcing the closed sector requirements. The evidence in Tables 5 and 6 indicates that the FIRB attaches conditions to only one-third of approved proposals. These conditions generally deal with matters other than the undertakings on economic performance required by the FIRA.

The FIRA, like the FIRB, required the sponsors of each proposal to submit a list of the benefits associated with the proposal. The critical difference is that the 'undertakings' required by the FIRA covered a range of economic performance issues and were legally binding once the minister conveyed them to the firm in writing. The FIRA monitored the firm's adherence to its undertakings and was prepared to enforce them. As I have noted, the FIRB's evaluation involves a necessary condition of net economic benefit, and the agency will assess particular aspects that it considers important. There is no effort to monitor all of the benefits, however, apart from the few items of central concern noted earlier. In Canada, many of the undertakings given by firms and confirmed in the letters from the minister were very general statements of intentions, or they were hedged by conditions that made them amount to little more than a pledge by the firm to do its best.[23] Obviously it would have been difficult to hold firms to undertakings of this kind. However, judging by the more important cases that have been made public, many other undertakings were unqualified and specific. Moreover, the FIRA surveyed these more rigorous undertakings each year until they were met, utilized random audits to confirm the reports, and spent considerable time in deciding what to do in case of non-compliance (Harvey 1981, 144-5, 174-7). My comments in Chapter 2 on the legal status and the enforcement provisions of the FIRA and the FIRB underline the differences between the agencies.

It was emphasized above that from at least 1976 on the FIRB enjoyed a fairly clear mandate for its emphasis on Australian participation and on defining the key tradeoff between ownership and performance. The FIRA had no such clear mandate. Its many objectives were not assigned relative priorities, and the question of what constituted an acceptable tradeoff between performance and ownership was never clearly answered.[24] For much of the FIRA's existence, the outcome of this lack of a clear mandate was considerable uncertainty among

potential investors about what was necessary to achieve entry, significant delays at times, and a review process that was widely regarded as being overly legalistic and bureaucratic.

Another outcome was a disallowance rate for the FIRA that was often significantly higher than the rate for the FIRB and also somewhat more variable. It is difficult to make such comparisons, of course, given the differences in coverage noted and the fact that, in both agencies, preliminary discussions could affect both the decision to make a formal proposal and its chances of succeeding. One can only note that neither agency operated on the principle evidently followed by some other such agencies, whose rejection rates are zero only because it is considered inappropriate to reject a formal proposal. This being said, it can be seen from Tables 5 and 7 that rejection rates were much lower for the FIRB than they were for the FIRA throughout the 1975-84 period, averaging 2.4 per cent for the former agency and 7.0 per cent for the latter. Proposals were withdrawn for a variety of reasons; in Canada's case, it has been suggested that 40 per cent of withdrawals in the earlier years were made in expectation of disallowance (Canada, FIRA 1978-9, Supplement). Withdrawal rates, like rejection rates, were much higher for Canada, averaging 9.6 per cent compared with 5.1 per cent for Australia. (Data for Canada are available for a longer period than data for Australia.) It appears also that the Canadian rejection rate was more variable than the Australian rate, showing significant decreases in 1978 and 1983 and a significant increase in 1981.[25] The Australian rate rose steadily after the first few years; although it fluctuated greatly in percentage terms, it was under 4 per cent until the most recent year.

Domestic ownership

Both Canada and Australia, in common with other countries, have partially or wholly closed a few sectors to foreign ownership or control. Opportunities for domestic participation were mentioned in the guidelines for both the FIRA and the FIRB. In each case more weight was given to domestic participation, especially in takeovers, if foreign ownership was already high in the relevant sector. In both countries the change in control of the foreign parent could trigger a review that might lead to reduced foreign ownership or even divestment of the subsidiary.

Nevertheless, it is quite clear that Australia has put a greater weight on domestic ownership and has done so explicitly. It was noted earlier that the tradeoff between domestic ownership and economic performance, where it exists, has been spelled out more fully and publicly in Australia. Increases in foreign ownership of 15 per cent or more are reviewed in Australia, even when control has not changed. Most important, a preference for domestic participation in the resources sector was spelled out earlier and more broadly in Australia than it was in Canada.

Policy on Australian participation in natural resource ownership developed all through the first half of the 1970s. In 1970, for example, uranium was declared a key sector. By 1973, this designation had been effectively extended to mining in general. By 1975-6, Australia had developed a quite specific policy of requiring 50 per cent Australian ownership and voting power on boards for all new natural resource projects and, in some circumstances, for projects in certain other sectors as well, including urban real estate. This policy enjoyed bipartisan support and remained reasonably clear and stable once it was established, despite changes in government.[26]

In Canada the situation was quite different (except in the uranium sector, where foreign ownership was restricted in 1970). Prime Minister Trudeau announced in 1974 that the Liberal party had set an objective of at least 50 per cent and preferably 60 per cent Canadian ownership of the equity in major new projects in the natural resource field. Had this objective been implemented formally, a matter that would have required some difficult negotiations with the provinces, it would have been very similar to subsequent Australian policy. It appears that the minister responsible for the FIRA was expected to work towards this goal where feasible, both before 1980 but especially after, without the benefit of either legislative support or public clarification.[27] The Canadian federal position, while it had some antecedents in both the provincial and the federal spheres, was not fully developed until 1980-1. It applied to the petroleum and natural gas sector, not to natural resources as a whole. It encouraged public and private repatriation of entire firms or parts thereof. It aimed for control, both private and public, and not just ownership. Unlike Australian policy, the Canadian policy did not survive a change in government.

Recent developments in Canadian policy

The operations of the FIRA were substantially changed in 1982-3 in order to clarify the bases of the agency's decisions and to simplify and speed up its procedures. The rejection rate fell sharply. These modifications were not enough to satisfy the Conservative government elected in mid-1984. In December of that year, the new government proposed legislation that would replace the Foreign Investment Review Act with the Investment Canada Act. The latter act came into force on 30 June 1985. Any assessment of the new agency must await experience of its operations, but in both intent and design it is clearly quite different from the FIRA.

The mandate of Investment Canada is to encourage and facilitate investment by both Canadians and non-Canadians. The minister and the agency provide a number of investment services to that end. The review process will no longer be required in the great majority of cases. Specifically, notification rather than review is all that is usually required when non-residents establish new Canadian businesses or make direct acquisitions of Canadian businesses with assets under $5 million. Nor will review normally be required for most indirect acquisitions of business with assets under $50 million. Indirect acquisitions result when control of the parent changes outside Canada; however, the $5 million threshold applies in this case also if the Canadian business represents more than 50 per cent of the assets involved in the total international transaction.

Review of new businesses and acquisitions can occur regardless of size in a set of activities related to Canada's cultural heritage or national identity. These activities, which were specified when the act came into effect (a list that can be amended), include the production, distribution, sale, or exhibition of books, magazines, periodicals, and newspapers; film and video products; audio and video music recordings; and music in print or machine-readable form.

What also remains subject to review are all direct acquisitions of control of Canadian businesses with assets of $5 million or more, and indirect acquisitions as just noted. While such proposals amount to only about 10 per cent of the *number* of proposals that were reviewable before the new act came into effect, they appear to cover two-thirds or more of the *value* of proposals. Recommendations to the minister no

longer have to go to the cabinet, and specific time limits are set for review.[28] The criterion of significant benefit has been changed to one of net benefit. However, the detailed criteria noted above for the FIRA are virtually unchanged except for the addition of the effect on Canada's ability to compete in world markets, and firms will still be expected to make undertakings in some cases.

In general, the language of the Investment Canada Act implies a more welcoming attitude to FDI and a set of procedures less complex than those implied by the previous act – although, as noted, many of the changes were anticipated by the procedures used after 1982 and especially after the election of 1984. Like all such review mechanisms, of course, the new act can be applied more or less restrictively in practice. The guidelines under consideration in mid-1985, as outlined by the president of Investment Canada, suggested a much less restrictive approach than that taken by the FIRA (Labbe 1985).

Early in 1985 the federal government reached an accord with the three western petroleum-producing provinces that will, over the next few years, effectively phase out much of the National Energy Program enacted in 1980-1. Among other things, the new accord deregulates oil prices and significantly reduces taxation of the industry. Three major NEP policies of direct relevance to this paper are being repealed. The special energy tax for buying MNE assets has been ended. The provision for a 25 per cent Crown interest in petroleum rights on federal lands, applicable to all private investors, will be withdrawn. The incentive grants for exploration and development, which were geared to the degree of Canadian ownership of the company, will end on 31 March 1986, subject to transition arrangements. The present government's willingness to assist efforts to increase Canadian ownership of the petroleum industry is evident in the permission given to Petro-Canada in mid-1985 to help Canadian investors purchase a major foreign-owned petroleum firm. Such episodic involvement is a far cry from the concerted policies for Canadianization pursued by the preceding government.

4
Effects and evaluation

The economic effects of closing sectors to foreign investment have been analysed elsewhere and the effort need not be repeated here (Safarian 1983a, chap. 3). I shall concentrate instead on the review processes in Canada and Australia and the two countries' approaches to natural resource ownership.

The success of policies designed to close specific sectors to FDI depends on a number of factors. In this context, it is understood, success means achieving the desired steering effects without significantly reducing the inflow of direct investment: neither Canada nor Australia has taken the position that it is prepared to accept a major overall reduction in FDI, as distinct from reducing it in certain key sectors such as energy. The bargaining power of governments in such situations depends on many factors, four of which I shall highlight here. One consideration is timing: if such policies can be introduced while resource rents are rising, the bargaining power of host countries is much enhanced. A second factor is the extent to which the policies are consistent with the strategies of MNEs, and hence less likely to run into resistance or evasion. A third consideration is the design of the instruments – specifically, how likely they are to achieve the objectives involved without negative side-effects. Finally, there is the issue of retaliation or threats of it by foreign governments that believe their interests are damaged or that come under significant pressure from those affected.

In both countries, policies on FDI tend to be correlated with rising resource rents. As rents rise, demands that they be shared become stronger, governments can exert more bargaining pressure without losing the FDI, and accompanying strength in other aspects of the economy diminishes concerns about any negative income or employment effects that the policies might bring. The problem is that it may take time to develop a consensus among the interest groups involved and to implement new policies, and meanwhile the resource rent situation may change.[29] Increasingly critical views on MNEs were heard in Australia in the late 1960s and early 1970s from both Liberal-Country and especially Labour politicians, and important legislative and policy changes were introduced. Responsibility for the substantial decline of the capital inflow in the period 1972-3 to 1975-6 (Table 8) can be assigned only in part to the Labour government's policies and statements: the demand for some of Australia's resources was relatively weak in this period, and an international recession had struck. Nevertheless, the experience had a sobering effect on the succeeding government, whose members favoured less restrictive policies in this area in any case. While resource prices weakened again towards the end of the period shown in Table 8, both direct investment and overall capital inflows remained high.

By 1975-6, both the FIRB and a clear resources policy were in effect. In Canada, the debate over foreign investment policy extended all through the 1960s and the early years of the 1970s, producing a significant number of policy changes by sectors and otherwise as already noted. However, the FIRA began reviewing takeovers only in 1974 and new businesses at the end of 1975, and the NEP was not introduced until 1981.[30] Canada had firmly established itself as the world's major host country for direct investment, a position yielded to the United States (in absolute terms) only in the early 1980s. Nevertheless, Canada's relative attractiveness to FDI had probably begun to decline before the FIRA was established; hence Canada's bargaining power was not as strong as it might have been – especially given the range of objectives assigned to the FIRA. Foreign ownership and control of Canadian industry, for example, had reached very high levels by 1970, but fell steadily and substantially thereafter. At the end of 1982, companies whose equity was controlled abroad accounted for 49, 45, 43, and 26 per cent respectively of the capital in Canadian

TABLE 8
Inward foreign investment in enterprises in Australia by type of investment: 1960-1983 ($A million)

	Direct investment investment		Portfolio and institutional loans	Total
	Undistributed income	Other direct investment		
1960-1	113	262	96	473
1961-2	66	155	76	297
1962-3	109	275	83	467
1963-4	138	287	28	453
1964-5	124	416	44	584
1965-6	125	387	182	694
1966-7	115	249	153	516
1967-8	228	333	420	964
1968-9[a]	250	349	405	1004
1969-70	221	514	305	1040
1970-1	238	657	695	1590
1971-2	224	646	584	1454
1972-3	307	93	70	471
1973-4	430	185	-120	496
1974-5	246	411	346	1003
1975-6	614	-38	282	858
1976-7	655	412	482	1549
1977-8	662	386	282	1330
1978-9	814	633	612	2059
1979-80	1021	552	1447	3020
1980-1	781	1597	3612	5992
1981-2	330	2024	7059	9413
1982-3	380	1338	7181	8898

a Some discontinuity in the treatment of mining and petroleum expenditures occurs prior to 1968-9 and from then on, while some insurance items are placed in the current account after that date. See the 1979-8 report of Australia, Bureau of Investment, 38.
SOURCES: Australia, Bureau of Investment (1983, preliminary) and earlier issues. Data for 1981-2 and 1982-3 from Australia, FIRB (1983), 27.

manufacturing, petroleum and natural gas, other mining and smelting, and all industry outside agriculture and finance. The comparable figures for 1970 were 61, 76, 71, and 36 per cent.[31] A more telling figure is Canada's share of inflows of direct investment to the 13 developed countries that receive the greater part of the world inflows. Canada had 16 per cent of the total inflows in the period 1961-7, 12 per cent in the period 1968-73, and only 3 per cent in 1974-9. It is true that the Australian share of this total also fell, more slowly, from 16 per cent in the first period to 13 per cent in the second and to 10 per cent in the period 1974 to 1976.[32] However, absolute FDI inflows recovered thereafter in Australia while weakening in the second half of the 1970s in Canada. Also, because of the repatriations under the NEP, Canada experienced substantial net outflows of FDI in 1981-2. When inward flows are combined with changes in undistributed earnings, the Australian experience with inward FDI still looks more stable than the Canadian experience (Table 8 above and Table 9). The NEP was a policy based largely on the expectation of increasing energy prices and resource rents. Its introduction almost coincided with sharp decreases in these prices and rents, as I shall note further below.

STRATEGIES OF MULTINATIONAL ENTERPRISES

A central question in the theory of FDI is why firms go abroad through subsidiaries rather than using exports or licenses. These other means of transferring the knowledge of the firm have the advantage of avoiding many of the costs of coping with a different environment, with long-distance management, and with government policies directed to foreign-owned firms. Internalization theory suggests that the specific advantages that a firm possesses, especially in its less tangible factors of production, can often be more profitably exploited through the organizational form of subsidiary firms than through exports or licenses, or even joint ventures. The reasons for this can vary greatly, from the relative ease of transfer of techniques between related parties to the attempt by the firm either to limit opportunistic behaviour by other firms or to engage in such behaviour itself. Obviously one cannot predict *a priori* whether internalization leads to positive outcomes from the viewpoint of national or international welfare, as distinct from that of the MNE. Everything depends on whether emphasis is placed on the effects arising from any restriction

TABLE 9

Flows and undistributed earnings of direct investment to and from Canada, 1960-84 (millions of Canadian dollars)

	Inward			Outward			Net	
	(1) Flows[a]	(2) Change in undistributed earnings	(3) Total	(4) Flows	(5) Change in undistributed earnings	(6) Total	(7) Flows (1) – (4)	(8) Totals (3) – (6)
1960	670	280	950	50	n.a.	–	620	n.a.
1961	560	240	800	80	n.a.	–	480	n.a.
1962	505	325	830	105	n.a.	–	400	n.a.
1963	280	435	715	135	n.a.	–	145	n.a.
1964	270	480	750	95	n.a.	–	175	n.a.
1965	535	735	1,270	125	n.a.	–	410	n.a.
1966	790	640	1,430	5	n.a.	–	785	n.a.
1967	691	845	1,536	125	n.a.	–	566	n.a.
1968	590	810	1,400	225	167	392	365	1,008
1969	720	1,045	1,765	370	105	475	350	1,290
1970	905	830	1,735	315	342	657	590	1,078
1971	925	1,335	2,260	230	333	563	695	1,697
1972	620	1,545	2,165	400	–65	335	220	1,830
1973	830	2,165	2,995	770	571	1,341	60	1,654
1974	845	2,730	3,575	810	493	1,303	35	2,272
1975	725	2,553	3,278	915	487	1,402	–190	1,876
1976	–300	2,744	2,444	590	199	789	–890	1,655
1977	475	2,971	3,446	740	995	1,735	–265	1,711

TABLE 9 (continued)

	Inward			Outward			Net	
	(1) Flows[a]	(2) Change in undistributed earnings	(3) Total	(4) Flows	(5) Change in undistributed earnings	(6) Total	(7) Flows (1) – (4)	(8) Totals (3) – (6)
1978	135	3,720	3,855	2,325	811	3,136	–2,190	719
1979	750	4,783	5,533	2,550	1,570	4,120	–1,800	1,413
1980	800	5,442	6,242	3,150	808	3,958	–2,350	2,284
1981	–4,400	3,700	700	6,900	–350	6,550	–11,300	–5,850
1982	–900	1,300	400	950	–2,779	–1,829	–1,850	2,229
1983	200	4,700	4,900	2,700	n.a.	n.a.	–2,500	n.a.
1984	2,380	n.a.	n.a.	4,025	n.a.	n.a.	–1,645	n.a.

a Gross inflows minus gross outflows, including in the latter acquisitions of direct investment interests in Canada from non-residents. A similar interpretation applies to outward flows.

SOURCE: Canada, Statistics Canada (various quarters) *Quarterly Estimates of the Canadian Balance of International Payments*; and Canada, Statistics Canada (various years) *Canada's International Investment Position*. The last three figures for changes in undistributed earnings are preliminary estimates supplied by courtesy of Statistics Canada.

of competition or on the role of firms in overcoming imperfections in the markets for technology development and transfer. The case for the latter view of the MNE may be stronger where newer and more sophisticated techniques are involved. To put the matter differently, governments may have more difficulty in persuading firms to give up 100 per cent ownership of a subsidiary in such circumstances, and may also find fewer or less effective substitutes through other methods for transferring technology. There is a significant body of theoretical literature and testing that gives credence to this view.[33]

If this theory is correct, one would expect that firms would be more likely to give undertakings for their relatively mature products and processes and also for the types of activities they are prepared to locate outside their regional or global headquarters. One would also expect that, insofar as FDI means a reduction of parent ownership (as distinct from loss of control), it will be undertaken more readily by firms in many natural resource industries than by firms in many manufacturing sectors and some service sectors. The intangible assets that a firm in the natural resource industries may try to protect are likely to be in marketing and technical know-how, for example, and are left relatively intact by some diminution in ownership. The intangible assets of a manufacturing firm are likely to be in patents, product differentiation, and proprietary information, for which the rents are harder to realize when ownership is diluted, even when the firm is able to impose and enforce many restrictions on the subsidiary or independent user. Important qualifications occur in each case, of course, and more sectoral disaggregation in particular is needed for such analysis. One should recognize also that there are more possibilities today than there were earlier for countries to bargain for the transfer of technology outside subsidiaries.[34] This is so partly because there are more MNEs based in a larger number of countries and partly because the pace of change in the product cycle has speeded up.

The FIRA challenged the concept of internalization by attempting either to decentralize or to capture for Canada a range of activities that many MNEs prefer either to centralize (such as many kinds of R&D) or to have some central say in allocating (such as some types of exports).[35] Undertakings or performance guarantees of the type required by the FIRA were disincentives to investment from the firm's viewpoint, since they tended to reduce its overall rate of return. They

were also, in effect, the price that the firm had to pay in order to gain entry to Canada, to merge, or to expand in unrelated lines of activity. It is not possible to know just how successful the FIRA's efforts were in assuring benefits. The only real evidence we have are the undertakings for each allowed proposal, published under ten broad categories by industry and country of control but with no indication of the size of the firm. This information is a good deal less than what is necessary for an analysis of the micro welfare effects, much less any possible macro effects, of the FIRA's operations. For example, we know nothing about the original proposals to the FIRA, or (in most cases) of the actual undertakings, much less how much of either one can ascribe to the FIRA.

The approach adopted in the National Energy Program also poses a challenge to the internalization thesis, since it substitutes domestic public and private ownership and control for part or all of the assets of the MNE. There are qualifications one should make here: some of the incentives in the NEP tend to encourage joint ventures with independent Canadian firms rather than supersede MNEs, and some tend to encourage the creation of Canadian-controlled MNEs. Nevertheless, the contrast with the Australian case is unmistakable. There is no integrated major public firm comparable to Petro-Canada engaged in the natural resource sector in Australia. There has been no major effort in Australia to seek domestic control rather than ownership. The Australian government does not maintain a substantial set of incentives and regulations designed to induce partial or compete repatriation of foreign subsidiaries. The effect of Australian policy is to leave control of the subsidiary with the MNE, while diluting equity in particular projects.[36] It is generally up to the MNE to decide on the form of domestic participation. It decides on the price it will charge local participants, and hence how far it will go in trying to capture any rents. The MNE is subject to some pressure from the government on major deals especially, if only because it knows that the project can be declined and that deferrals of domestic participation are temporary. But, so far as one can tell, the FIRB does not put itself in the position of dealing for one party or the other.

The effectiveness of the approaches used by the FIRA or the NEP is clearly not simply a question of the likely response of firms, but also of the timing issues already noted and of the way in which policies are designed and implemented. While it is difficult to disentangle the

various elements noted, some aspects of the design of the policies and of the reactions to them are worth noting before we consider why they evolved as they did.

SOME CONSEQUENCES OF POLICY DESIGN

Australia

Some researchers and officials (especially outside the Department of the Treasury) would argue that Australian government policy generally and the FIRB in particular are rather vague in their objectives, uneven in application, and less informative or accountable than is necessary or desirable. It is not difficult to document some of these charges (see the first part of Chapter 2). Given the experience in Canada and elsewhere, it would be difficult to support this general criticism. As such policies go, the Australian policy had reached a reasonably stable and clear position by the mid-1970s, after a somewhat turbulent period of development. Moreover, because the policy concentrated on future projects rather than on buying out existing assets, it had more downside protection than the Canadian approach if forecasts of resource demands and prices were wrong. The policy also enjoyed more bipartisan support than its Canadian counterpart, and it continued to attract a significant capital inflow while increasing Australian participation and ownership – albeit more slowly than the Canadian approach. In the decade before 1972-3, foreign ownership of Australian mining had doubled (McKern 1976, 37). The government discontinued the collection of data on foreign ownership during the period 1978-82, so that it is difficult to be precise about some of the changes in the 1970s. Table 10 indicates that, after the adoption of the 50 per cent rule in the mid-1970s, direct foreign ownership of minerals fell by 5 percentage points (1974-5 to 1981-2). The decline is likely to have continued in recent years.[37] It is more difficult to trace the degree of control, since detail on various types of control is lacking for the years before 1981-2, when 30 per cent of the industry was in firms whose equity was 100 per cent controlled abroad.

The Australian concentration on domestic participation in new projects is not costless, of course. The capital used has an opportunity cost, and, as in Canada, it must be imported in non-equity forms when Australians cannot supply it. The late 1970s and early 1980s have

TABLE 10
Foreign ownership and control of Australian mining

	1972-3 (%)	1974-5 (%)	1981-2 (%)
Ownership			
Foreign ownership			
– direct foreign ownership	37.5	40.9	35.7
– other identified foreign ownership	12.0	10.9	15.6
Australian ownership	50.5	48.2	48.8
Total[a]	100.0	100.0	100.0
Control			
Foreign control			29.8
Joint foreign and Australian control	57.7	60.1	22.4
Naturalized or naturalizing			5.8
Australian control	42.3	39.9	42.1
Total[a]	100.0	100.0	100.0

a Totals may not add due to rounding.
SOURCE: Australian Bureau of Statistics (1981-2) *Foreign Ownership and Control of the Mining Industry and Selected Mineral Processing Industries, Australia, 1981-82.* Reproduced from Australia, *FIRB Report* 1983, 34. Data based on value added.

been periods of high real interest rates, and the recommendation often made earlier in both countries to rely less on foreign equity and more on debt financing from abroad does not look as attractive as it once did. Moreover, there are important income distribution issues associated with both the Australian and the Canadian approaches to ownership issues.[38]

The Australian policy does not require joint venture partners or even majority domestic ownership. As Caves (1982, 91-3) has noted, this is not an ideal way to collect rent. A knowledgeable joint venture partner has some possibility of sharing rents, particularly if he supplies technology or markets. Where competitive stock markets are

involved, the MNE can capitalize rents when it sells shares in its subsidiary, and the local shareholders will get only a normal return. In Australia, the parties involved are generally left to themselves to come to a commercial decision on the precise timing and terms of local participation.

The fact that the policy exists and that the market was not always competitive means that some rents may have been shared with local investors. Australian equity markets and joint venture partners were not well developed in the 1960s and early 1970s, with the result that a few financial institutions such as insurance companies took up large parts of the Australian equity involved.[39] A study of major resource projects for the 1960s suggests that Australians investing through the market paid more for their equity in foreign-owned projects than the foreign owners paid. By contrast, cases in which Australian firms were directly involved show Australian participation at par (McKern 1976, 46). These estimates apply to the period before the 50 per cent Australian participation rule was adopted.

The view often heard from Australian officials is that Australia has no capital gains tax and that, while the states collect royalties, some states subsidize projects too heavily because of competition for the investments; hence the policy of 50 per cent Australian participation in new projects serves as a net for capturing some of the rents that might otherwise escape. Yet a government that wishes to capture economic rents has at hand a more effective and equitable instrument than the 50 per cent rule – namely, to tax the rents through either general tax policy or policy aimed specifically at resource rents. Taxation is not only more likely to collect the rents; it also assures that the public at large receives the larger share of the benefits of resource development, rather than the institutional investors, domestic mining firms, or the equity market more generally.

There has also been some concern in Australia about the effects that the boom in resources has on other sectors, by increasing wage and other costs, raising the exchange rate and thus increasing import competition, and absorbing huge capital and tax outlays. The question of an appropriate policy response to the resource boom is complex, but one aspect is closely related to the present focus. The 50 per cent rule adds to the pressures that the resource boom has on other sectors. Combined with subsidies to resource investment, the 50 per cent rule tends to steer large amounts of equity financing to the

resource sector. Presumably, this raises capital costs to other sectors or increases the import of capital in non-equity forms. Australian investors, as a consequence, are more heavily involved in resource investments and (assuming the savings rate is stable) foreign debt instruments than they would be in the absence of the 50 per cent rule. Whether such a degree of involvement is desirable or not depends on assumptions one makes about the alternative investments and outcomes, but it appears to be a fairly direct result of present policies. This issue was raised as early as 1972 by a Treasury Economic Paper:

> Although the question of local equity participation in foreign-owned subsidiaries, like that of foreign takeovers, raises important non-economic considerations, it needs to be recognized, nevertheless, that such participation cannot, in general, add to Australia's total capital resources and extend Australian ownership of domestic assets *unless it occurs via an increase in the rate of domestic saving or is financed by overseas borrowing*. It can, in fact, reduce these resources – though not Australian ownership – if Australian equity participation (financed by a given level of domestic savings) in new enterprises displaces overseas capital that would otherwise have come in for these enterprises or if overseas capital released by Australian equity investment in existing foreign subsidiaries moves out of the country. (Australia, Department of the Treasury, 1972, 96)

The paper went on to note that by well-timed share issues the MNE could increase the size and profits of its subsidiary while maintaining control and investing less than it would otherwise invest. Such outcomes are not uncommon in mining, in particular, and do not necessarily yield a higher return than alternative uses of Australian savings (ibid., 97).

Partly because of the high degree of foreign ownership, there has been an extensive debate in Australia on the taxation of resource rents. The crucial question is how to determine and tax economic rents – that is, without distorting production decisions. Just how this might be done has been examined in some detail by Garnaut and Ross (1978, 1983). The new Labour government has, in fact, proposed a resource rent tax for new oil and mineral developments, a tax that has met strong opposition from the states with such resources. A more

limited proposal for offshore oil fields discovered after 1975 was under discussion in mid-1984.[40]

It was noted above that natural resource development is the direct responsibility of the state governments, which supply infrastructure and collect royalty income. It is the state governments that bargain with the firms on these matters, while the responsibility for regulating ownership and exports rests with the central government (although the FIRB has a policy of consulting state governments about significant cases). In fact, several states have passed ownership legislation of their own. Thus New South Wales attempts to secure at least 51 per cent Australian equity on new projects rather than 50 per cent, Victoria has legislation (rarely used) allowing it to examine foreign takeovers that affect the 'general public interest', and Queensland has moved at times to protect local firms against both interstate and overseas bids. These policies do not appear to have led to serious federal-state conflicts (Sexton and Adamovich 1981, 190-5). However, the state governments, when dealing with foreign investors, are not averse to pressuring the national government to ensure that the investments occur, to that extent reducing any bargaining power that the national government may have.[41]

What has led to difficulties, especially between the Commonwealth government and the governments of Queensland and West Australia, is a range of other issues. The federal government has control over exports. Through the federal-state loan council it can exercise control over state borrowings abroad.[42] Only the federal government levies income tax; hence the way in which it makes financial grants to the state governments can significantly affect financing for major resource projects. Conflict arises because of differences in the views of governments over the pace of the resource boom, who gains from it, and how it should be managed. Thus the federal government has tried at times to moderate the pace of development in one or two states because of the impact on non-resource sectors and on macro management of the economy – for example, on interest rates. The central government has also indicated concern that the benefits to Australia from major resource projects have at times been reduced by low charges for electricity, royalty rates, freight rates, and infrastructure costs generally – low charges that are sometimes brought on by competition for investments between the states. The

states in turn believe that the central government's policies favour the more populous and developed sectors.

It will be recalled that a number of approvals by the FIRB are conditional on appropriate arrangements being made on tax questions. Such arrangements are particularly important in the case of natural resource projects, where, despite the political difficulty involved in delaying projects, the federal power over exports has been used to assure acceptable prices and also to deal with environmental concerns. The federal government is anxious to avoid low export prices, which would reduce Australian tax revenue. In the area of raw material exports, there is often a market price for comparable products that can be used for price comparisons, and projects are frequently large enough to warrant close comparisons. In manufactures, where customs authorities can and do check pricing, the job of evaluating transfer pricing is much more complex, given the frequent lack of comparable products.

Canada

Much of the above will sound very familiar to a Canadian reader. The escalating federal-provincial conflict over resources policy, especially petroleum and gas policy, after the early 1970s paralleled developments in Australia. Similar policy questions arose in both countries. One reason for the introduction of the NEP was concern about the size of the profits that would go to the largely foreign-owned petroleum and gas industry, given what was expected to be a continued rapid rise in world prices. However, taking an ownership approach to this problem begged several questions, as it did in Australia. The planned reduction of foreign ownership would still leave 50 per cent of the industry's revenues foreign-owned, revenues that the government expected to be excessive. A major reason for the capture of rents by the industry, especially by the integrated foreign-owned firms, was the federal government's depletion allowances, which it considered overly generous, and which it had the power to adjust. The federal government argued that federal-provincial tax arrangements and the division of constitutional powers blocked the use of tax measures as a way of securing more rent for the federal sector. Yet the NEP did impose substantial new taxes, some of which had to be set aside when oil prices collapsed. If one reason for taking the NEP route was to avoid federal-provincial conflict, then the

confrontation and settlement with Alberta in 1981 demonstrated that the route taken did not lead to the intended destination.

As noted above, the NEP approach involved substantial fiscal incentives for both public and private firms to purchase foreign-owned assets. The overall costs of such purchases depend on a number of variables, specifically:

- the price paid for the asset;
- the likely expected value of the income from the asset;
- the interest cost of capital used for the purchase;
- the cost of resources used directly to administer the policy; and
- the extent of retaliation by or disruption in relations with other countries.

The anticipated gains included more domestic ownership and control (private and public) in what was expected to be a rising rent sector and increased leverage in such matters as domestic purchasing for the major projects that were expected to follow (see Canada, Energy, Mines, and Resources 1980).

As it turned out, the variables moved in the wrong direction, given the purposes of the NEP, and the economically depressing effects of some of the decisions made with the encouragement of the NEP will linger for years. In a number of cases, the prices paid for firms appear to have been well over the premiums above stock market prices customary for such mergers, a result attributable in part to the euphoria about rising rents. The expected value of income from the assets fell as recession arrived and oil prices declined. Interest rates shot up in 1981 in both real and nominal terms and have stayed high in real terms. It turned out to be quite complex and costly to administer the detailed ownership requirements and some other aspects of the program. Canadian policy invoked a very hostile response in the US press and in Congress, and relations between Canada and the United States deteriorated significantly for a time. The US government ultimately decided against direct and explicit retaliation, although, as noted above, it cited some aspects of the FIRA as violations of the General Agreement on Tariffs and Trade (GATT). The Liberal government did not change the fundamental aspects of this part of the NEP, but it did modify payments for the 25 per cent Crown interest, underline that this was a special program designed to

cope with problems in a major sector rather than a prelude to similar programs elsewhere, and set aside plans to strengthen the FIRA. The objective of increased leverage on domestic purchasing for major projects had to be modified as well, in part because the possibility of realizing this objective melted away with the declining price of oil and in part because the pursuit of such leverage was contrary to the government purchasing code in the GATT. Like other countries, however, Canada does require that domestic sources of supply be considered on a competitive basis by firms that undertake major resource projects.

One major effect of the NEP was that Canadian ownership of petroleum revenues rose almost 7 percentage points in 1981 alone; payments for identified repatriations amounted to $7.5 billion. About 60 per cent of this increase in Canadian ownership and control have continued to rise, more slowly, since then. Petro-Canada has become a major integrated firm. Control of one of the largest integrated foreign-owned subsidiaries was purchased by a Canadian-controlled firm in 1985, after the revisions to the NEP had been announced. This purchase resulted in part from a change in the controlling interest abroad, which automatically led to review in Canada, and the new parent firm's desire to reduce the debt associated with its merger.

The costs of the repatriations under the NEP in the early 1980s were significant. In the absence of a federal government surplus or the prospect of soaring resource taxes, and given the weakening international situation at the time, the outflows involved in repatriation put much downward pressure on the exchange rate and upward pressure on interest rates in a period of rising unemployment.[43] From a longer-term perspective, the effects of these repatriations on the foreign share of net rents may have been negligible if one assumes a real after-tax opportunity cost of 7 per cent. The prices paid for the takeovers were apparently too high to allow such a return in the years afterwards (Helliwell et al. 1983, 28). The exploration incentives did favour rent recapture, however. As noted earlier, the government announced in 1985 that much of the NEP, including the fiscal incentives for repatriation, would be phased out.

The attempt to assure net benefit from FDI by negotiation involves detailed knowledge and skilful handling by the government negotiators and, as well, a high degree of policy co-ordination more

generally. This observation is all the more valid when a government attempts a program as ambitious as Canada's FIRA and the agency is required to operate in the context of a high degree of law and information by international standards. The task of the FIRA was greatly complicated by the failure of the cabinet to clarify the mandate and priorities of the agency, which made it difficult for the agency to let firms know what was expected of them and raised the question of whether net benefit could be assessed with positive welfare outcomes. Concern grew that both foreign investors and foreign governments were being given a more negative view than the Canadian government intended. The probable discouragement to new investment was examined in studies by the Conference Board (1984). In responding to the board's questionnaires, 11 per cent of the foreign firms that claimed to have seriously considered investment in Canada indicated that they had been deterred by foreign investment controls. A stronger outcome of the study was the indication by half of the firms interviewed (mainly the larger ones and those in 'sensitive' sectors) that the FIRA hindered their investment plans in Canada by delays, by apparent rigidity, and in other ways. Globerman (1979, 1984b) also believes that the FIRA has imposed net costs on the Canadian economy but argues that the costs are varied and difficult to measure. Some of these problems were addressed in the reform of the FIRA undertaken for the early 1980s, and others will be addressed by the switch from the FIRA to Investment Canada.

It will be recalled that, despite the problems noted, the Liberal government announced in 1980 its intention to significantly extend the scope of the act. These plans were shelved as a result of the outcry over the NEP. Criticisms from abroad led to a reference to the GATT about the undertakings on exports and imports made by firms to the FIRA. The United States in particular argued that these 'trade-related investment measures' were similar to tariffs, quotas, or subsidies and that they distorted trade. Canada took the position that the undertakings were needed to counter a bias by MNEs against Canadian production and, in any case, were not formal requirements. The GATT ruled that the undertakings contradicted treaty obligations for imports but not for exports. Canada accepted this finding and indicated it would modify the FIRA's procedures in line with it. In October 1984, the US Congress enacted a bill that, among other things, authorizes the president to negotiate the reduction or elimination of

any export performance requirement that is established by another country as a condition for US investment and that is determined to affect US economic interests adversely. The bill also grants authority to impose duties or other restrictions on goods or services from the foreign country and to deny importation of products that are subject to export performance requirements. This bill, it should be added, is aimed at many countries, not just Canada: some developing countries in particular are far more demanding and explicit in this regard. Judging by US Senate hearings on the subject, however, the FIRA played a significant role in highlighting the issue (US Senate 1981).

Retaliation

We can deal with this subject briefly, given the comments in the previous section. Both the Canadian and the Australian approaches to foreign ownership can be said to involve elements of non-national treatment; that is, treatment given to foreign-owned firms which differs from that accorded nationally owned companies.[44] However, Canadian policies that can be considered discriminatory or retroactive in their treatment of foreign-owned firms have drawn more attention from the firms' home countries than their Australian equivalents. Criticism of the FIRA abroad, while not as strong as it became in 1980-1, was frequently voiced in the late 1970s. Canada's proximity to the United States and the fact that so much of the FDI in Canada was from that country guaranteed a stronger reaction there to Canadian than to Australian policy initiatives. Yet British, West German, and (with less justification) French and Japanese criticisms of Canada's policies were no less pointed even before 1980-1, and certainly thereafter.

Quite apart from the effect of Canada's proximity to the United States, the design of the NEP made it much more likely than the Australian approach to invite retaliation. The petroleum incentive payments were geared to the degree of Canadian ownership of the firm and hence were explicitly discriminatory toward established foreign-owned firms. Both Australian and Canadian tax law had been used in ways that distinguished established firms by nationality of ownership, but nothing on the scale of the NEP had been attempted before (Safarian 1983c). The provision for a 25 per cent Crown interest in all petroleum rights for all firms on federal lands, while it applied to Canadian-owned as well as to foreign-owned firms and involved some payment for work done to date, was strongly criticized

as a retroactive measure. In the mid-1970s, domestic and foreign investors levelled some strong criticisms at the plans, actual or assumed, of the Australian Labour government, and there have been major disputes with firms since over some important projects. However, neither the FIRB nor the requirements for Australian participation appear to have attracted the degree of criticism abroad, or the explicit consideration of retaliation, that the FIRA and the NEP attracted.

5 Some reasons for the differences between Canadian and Australian policy

It was noted earlier that, particularly before the recent changes in Canadian policy, there was some similarity in the objectives of the Australian and Canadian governments. Both countries were interested in increasing domestic ownership, particularly in order to capture more resource rents, and both were interested in exerting some pressure on foreign-controlled firms in order to capture more industrial benefits nationally. Both countries emphasized political objectives as well; that is, the desire to maintain some degree of independence in policy-making in an increasingly internationalized context. However, the Canadian ownership instruments were more powerful, Canada's attempts to secure control and to improve performance were more ambitious, and Canada's policies after 1975 were not as stable as Australia's and did not enjoy the same degree of bipartisan support. Any attempt to fully explain the historic reasons for these differences, taking into account both internal and external lines of power and influence, would be a major study in its own right. The Canadian dependence on the United States for the great bulk of FDI, along with the high degree of integration between the two countries in other respects, does much to explain the strength of the Canadian reaction in political terms. Without downplaying the effects of such economic and political concerns on the policy outcomes, I shall briefly suggest some further reasons why Canadian policy and Australian policy have taken somewhat different directions.

FDI emerged as an important political issue in the late 1950s in Canada and the late 1960s in Australia. In both countries, the question of how to deal with FDI has raised important differences

between the national parties and even between ministers in the same government. For our purposes, it is enough to note that a more bipartisan consensus seemed to develop in Australia, after the Whitlam Labour government experiments of 1972-5, than has developed in Canada. [45]

One reason for this difference may be the point suggested earlier: that strong policies in natural-resource producing countries tend to be positively related to resource rents, both because there is the possibility of capturing them and because the balance of payments position or prospects appear to be strong. In the late 1960s and early 1970s, Australia was enjoying a resource boom, the inflow of foreign investment was substantially higher than it had been, and relatively full employment existed. All of this had changed by the mid-1970s; specifically, the capital inflow was substantially lower for several years after 1972. The resource boom had clearly run into problems, but another reason for the decline in inflows was alarm on the part of foreign investors over the proposals and actions of the Whitlam government. Both the prime minister and the minister of minerals and energy had stated more than once their opposition to further foreign involvement in mining and tried to enforce requirements that made that opposition clear.[46] Towards the end of its period in office, the Whitlam government modified its position on these issues, and the Fraser government that succeeded it made a determined effort both to stabilize policy and to seek foreign capital. The experience of these years has lingered, despite the temptation at times to take the policies further.

In Canada, the major policy in the resource sector came with the second round of increases in petroleum prices in the late 1970s rather than the first round in 1973-4. The NEP reflected an attempt to deal with a variety of tax and other issues that had been the subject of federal-provincial dispute for some time, and not just issues involving MNEs. The precise timing of the NEP had much to do with electoral strategy in the period 1979-80, not least the politicization of both energy and MNE issues and the Liberal Party concern that the New Democratic Party (NDP) would reap the electoral benefits. Indeed, the NDP may have been responsible to some extent for the form that the FIRA had taken.[47]

It was also noted above that such issues take longer to resolve in the Canadian federation than the Australian because of greater regional

differences (Stevenson 1976). In any case, with the collapse of resource rents in the early 1980s, the Liberal government significantly reduced the role of the FIRA, and the Conservative government changed to a more liberal policy generally so far as inward direct investment is concerned.

It was emphasized above that the FIRB undertakes a narrower task than did the FIRA and, partly as a result, has developed a clearer decision criterion. In some other countries with review on establishment one often finds a major emphasis on negotiating increased net economic benefit, or at least on assuring that net economic benefit does occur, by requiring and monitoring conditions on subsequent economic performance. This approach is often accompanied by a view that the performance of such firms would otherwise be inconsistent with the national interest, in comparison with the performance of national firms that escape such review. Government concerns about MNEs cover a spectrum of economic and non-economic issues. Many of the economic concerns amount to a view that the subsidiaries are dependent on the parent or other affiliates abroad for a range of functions that might otherwise be performed domestically or at least controlled domestically. The outcome of substantial reliance on MNEs is believed to be a reduction in domestic innovation and industrial efficiency – as evidenced, for example, by little local research and development, a high propensity to import and a limited right to export, and an excessive number of product lines in manufacturing. This belief is accompanied by concern that decision-making in a MNE may at times be inconsistent with the national interest, given MNEs' mobility out as well as in, and given the ability of MNEs to transfer price in order to minimize taxes or escape government regulation.

In Canada, the set of concerns regarding economic performance is referred to as 'truncation' of the subsidiary. This view is firmly embedded in the Government of Canada report (Canada 1972), popularly known as the Gray Report, that recommended the establishment of the FIRA. It is a view that can be challenged, so far as Canada is concerned, both by questioning whether the evidence on foreign-owned firms is bad enough to warrant it, and by putting forward a much stronger alternative explanation of inferior economic performance by firms, regardless of country of ownership (Safarian 1979).

Whatever one's conclusion on this point, the idea that MNEs retard domestic innovation and efficiency receives little support either in the published literature on Australia or from most Australian government officials, despite a great deal of public concern about this issue in the 1960s.[48] The Australian Committee of Economic Enquiry (the Vernon Committee), which issued its report in 1965, took a critical stance on a number of important issues regarding foreign investment – a stance that was rejected by the government of the day. Mainly because of concerns about the balance of payments, the committee did not wish to see an increase in the level of 'new' capital inflow (total investment less undistributed profit). It also called for a review of takeovers and for Australian equity (especially joint ventures) in natural resources, and was concerned about a further substantial increase of foreign ownership. On the question of MNEs' effect on innovation and efficiency, however, it took a more cautious line, noting that the evidence on restrictive export franchises was inconclusive and that FDI had made 'a very great technological contribution' (Australia 1965, I, 291).

A major analytical study by the Australian Treasury is also instructive in this regard (Australia, Department of the Treasury, 1972).[49] It does not find the export or research performance of subsidiaries inferior to that of domestic firms; it regards the high import propensity of subsidiaries as an aspect of technology importation; it suggests that foreign investments have expanded management opportunities; and more generally, it attributes the problems of Australian manufacturing to extensive protection against imports and to other domestic policy positions. The study's conclusion on the micro-economic effects of FDI, while qualified on some points, seems to suggest they are favourable on balance, or at least not negative, and that where negative results exist the usual cause is inappropriate domestic policies (ibid., 76-7 and 125-6). This view is generally reflected in most of the private empirical studies of the period, notably Brash (1966), Sheridan (1975), and Carr (1978). There are qualifications, of course; thus Carr points to the problems of assessing the net benefit of FDI in a dynamic sense and to some possible stifling of innovative capacity. A detailed empirical study by Parry and Watson (1979) is inconclusive on the latter point.[50] Several government or government-sponsored reports on manufacturing in the 1970s have little to say on the subject of direct investment.[51]

None of the above should be taken to mean there has not been concern expressed about particular micro-economic effects of FDI. The Australian Labour party has been critical of some of these effects, as is indicated by the addition of the issue of limited export franchises to the FIRB's evaluation criteria in 1983. Some of the Australian literature is reminiscent of the dependency theories of direct investment that appear frequently in the Latin American literature on MNEs,[52] an approach that yields both negative economic and negative political effects over time. One may hear more on the issue as Australia attempts to restructure and modernize its manufacturing sector. My point is simply that it has not played a major role in the FIRB process to date, in contrast with the issue of Australian participation.

Quite apart from the debate over the substance of the issues and the position taken by the political parties and government ministers involved, one should note the influence that senior officials have had on the resolution of the issues associated with MNEs. The views of departmental officials on these issues vary considerably. For example, departments of regional development tend to be very favourably disposed to such firms, given their mandate and the fewer options for less developed regions. Departments involved in technical development tend to be less favourably disposed because of a preference for developing research locally rather than importing it. Finally, treasury officials often play a consensus role, and, in any case, are interested in the possible tax revenue and other macro gains from FDI.

It has been suggested that the Australian Treasury played a key role in insulating policy changes against political fluctuations. More specifically, Treasury officials in 1972 and later recognized the need to accommodate the political concerns about MNEs but attempted to minimize intervention. In Canada, the Industry Department apparently attempted a similar role but with less success.[53] The predecessor committees of the FIRB, while interdepartmental in composition, were all serviced by the Treasury. The executive member of the FIRB heads the Foreign Investment Division in the Treasury. In Canada, by contrast, a distinct agency was created, and it was made responsible to the Minister of Industry, Trade and Commerce. Consultation with other departments occurred in both countries, of course. The decision in Canada to send all cases to the

cabinet produced a more political process; that is, public and private interest groups were in a better position to influence the outcome than their counterparts in Australia. The Australian decision to place the responsibility for assessment on the Treasury tends to emphasize macro and general equilibrium concerns, while in Canada one would expect more emphasis on micro and partial equilibrium concerns. The different policy objectives of the two agencies reinforced these tendencies.

The development of the NEP accentuated this difference. Although the NEP was preceded by a government policy paper and presented in a government budget document, it was to a considerable extent the creation of the Department of Energy, Mines and Resources. Normally one would expect the finance minister and his officials to play the lead on such a major financial measure. Moreover, because the NEP was introduced in a budget document, the input from other departments was limited and that from the private sector came largely after the program was announced.

6
Conclusion: an alternative approach

To avoid any misunderstanding, it should be emphasized that this paper has not attempted to evaluate in detail the economic and political effects of MNEs.[54] The focus has been on the question of how effective the policies of the Australian and Canadian governments have been, given their objectives. Both sets of policies have pursued their ownership and performance objectives at some cost, though the less ambitious Australian approach has been less costly. In both cases, alternative policies have been available that would apparently avoid or reduce some of these costs or reach government objectives more effectively. In this concluding section I shall briefly reiterate these alternatives and note some of the obstacles to their implementation.

One approach would be to improve the present operations of each country's set of policies. In Australia, such improvement might include establishing a legal basis for new business review, tightening up of commitments regarding Australian participation, and placing more emphasis on joint venture approaches. Canadian policy might benefit from a clarification of how the criteria for net benefit will be applied by the new review agency and an emphasis on Canadian participation in new resource projects rather than repatriation. Australia has already begun tightening up on participation commitments. Canada may be moving to an Australian-type approach so far as federal lands are concerned, given the abolition of the petroleum incentive program and given the requirement for 50 per cent Canadian ownership at the production stage.[55]

Both governments, in trying to capture rents from resource development, have emphasized policies designed to increase domestic ownership, private or public. Another way to reach this particular objective is to use more effective tax policies directed at all firms. The literature on Australia suggests that it is possible to devise schemes of resource rent taxation that would minimize some of the adverse effects on firms' decision-making of fluctuations in such rents. It is true that both countries face difficult problems in trying to develop tax policies, or policies of any kind, for natural resource development. However, such problems are an inevitable consequence of the division of powers in a federal state; they cannot be avoided, whether regulatory or fiscal measures are used, and they certainly cannot be overridden for long by unilateral initiatives.

A similar point can be made about the attempt to capture more industrial benefits generally, as distinct from resource rents. It is a difficult exercise at best to assess net national benefit from particular investments, gauge the reactions of firms correctly (much less the reactions of other governments), and come out clearly ahead. It is virtually impossible if criteria are not weighted or at least ordered, or if the weighting of criteria is not made known to the firms, many of which value stability of policy at least as much as how more or less restrictive it is.

An alternative approach is to use more generalized fiscal and regulatory policies rather than policies that are highly discretionary and that are aimed at FDI. More generalized policies are more likely to avoid confrontations between countries and possibly within them as well. Less discriminatory policies will also address some similar issues in the domestically owned sector. This approach deserves particular attention in Canada, whose diminishing attractiveness as a host country and increasing role as a home country would seem to require that industrial policies apply to all firms, wherever they are controlled. Such an approach would not simply replace the FIRA with Investment Canada. It would aim instead to have policies, where they are appropriate, applied to all relevant firms. No doubt the government would wish to maintain a domestic presence in some key sectors by subsidy or other means, and some policies would have an impact more on MNEs, both domestic and foreign, than on other firms. Policies designed to reduce tax losses from transfer pricing practices are an example of the latter. But in many areas of economic

performance the case for a particular industrial policy can be made at least as strongly for domestic as for foreign-owned firms. Where still further decreases in foreign ownership are desired, there are many fiscal policies already in place that are designed to increase Canada's capacities to undertake investment and related activities. These policies could be strengthened without outright discrimination against foreign-owned firms.

Whether such a non-discriminatory approach is feasible, given some of the public perceptions about foreign control, is another question. MNEs impact very differently on private and public interests in the home country and the host country. Those who lose in economic terms or in terms of power, and those who weigh heavily any diminution of national independence, are likely to resist a non-discriminatory approach. If they happen to be relatively few and can organize easily, while those who gain have the opposite characteristics, it is not difficult to imagine a government taking actions that have negative effects on growth and that are regressive in terms of income distribution. It would certainly not be difficult to demonstrate effects of this kind from this study, among others.[56] Rents are potentially created for some domestic owners when sectors are closed, when the acquisition of firms by non-residents is reviewed, and when ownership must be shared with domestic participants. A preference for such instruments over generalized fiscal approaches directed to all firms may also be explained in part by an interest-group rent-seeking approach, especially where the procedures are somewhat opaque and uncertainty is thereby increased.

I do not mean to suggest by this that questions of national economic welfare and of independence have not played a significant role in the development of policy on foreign investment. Nor is policy irreversible simply because some groups might lose in the process; this is evident from the policy changes adopted in Canada in 1985. I have made these points simply in order to record some of the obstacles to alternative approaches, and to suggest why quite major pressures were needed both to adopt and to change policies in this area.

Notes

A NOTE ON SOURCES

My debt to various writers is evident from the sources listed in the bibliography. Australia and Canada are rather well served by information on the topic of this study, particularly in comparison with most other countries. For non-Australian readers, it may be helpful to cite several sources on Australia that I found especially helpful on the topics covered here. The Treasury study (Australia, Department of the Treasury 1972) achieves a level and a balance of analysis that is rare in public documents on this subject. The FIRB, like the FIRA, has published a great deal of information on policy and procedures. The fullest statements are in its 1982 report, which is complemented by its 1983 report and by the 1982 Treasury document entitled *Australia's Foreign Investment Policy: A Guide for Investors.*

Sexton and Adamovich (1981) offer a detailed commentary on Australian federal and state law and administration for the full range of foreign investment policies. Harvey (1981) offers a very detailed statement of how the FIRA and the FIRB operate and of the differences between them, emphasizing the legal and institutional aspects. Anderson (1984) offers similarly detailed comparisons, concentrating on the non-petroleum mining sectors. The most thorough economic analysis of the effects of foreign investment in the resources sector of Australia is by McKern (1976).

Apart from these and other sources listed in the bibliography, I have relied on interviews conducted in June 1981 in Sydney and Canberra. These were with officers of the FIRB; of the federal

Departments of Trade and Resources, Business and Consumer Affairs, and the Attorney General; of the Reserve Bank of Australia; and of two departments of the government of New South Wales. I also discussed foreign investment policy with a number of university economists in Canberra and Sydney who specialize in this area, and with the officers of a few firms with investments in Australia. Officials of the FIRB and of the Canadian High Commission in Australia were also very helpful. While the interpretations are my own, I am grateful to all of these people for their help.

1 Canada has the highest degree of foreign ownership of industry among the more developed countries. In 1982, for example, companies whose equity was controlled abroad accounted for 49 per cent of the capital in Canadian manufacturing, 45 per cent in petroleum and natural gas, 43 per cent in other mining and smelting, and 26 per cent in all industry outside agriculture and finance. Only in a few of the higher-income countries, such as Australia and Belgium, does foreign ownership of manufacturing amount to 40 per cent or so. In several others, such as Italy, France, West Germany, and the United Kingdom, the figure is between 20 and 30 per cent. For some, such as Sweden and Norway, it is closer to 10 per cent. For the United States and Japan, it is only about 5 per cent. Figures of 40 per cent or more of manufacturing have been reported for a number of developing countries, including Malaysia, Nigeria, Columbia, Brazil, Ghana, Turkey, and South Africa, while estimates of at least 30 per cent have been reported for Argentina, Mexico, and Singapore.

2 Statistics Canada (Canada 1980 and 1981, 40-1). Estimate for 1983 by courtesy of Statistics Canada. These figures should be distinguished from Canadian-controlled long-term investment abroad, which includes third-party investments by other residents and non-residents in the equity and debt of Canadian direct investment enterprises abroad. The former rose two-and-a-half times as much as direct investment in the three-year period from 1979 to 1982 for which such data have been collected. For a further comment and data, see Richards (1985).

3 See Arndt (1977) and Anderson (1984, chap. 4) for policy developments up to 1975.

4 For a statement of the procedures involved, see Australia (*FIRB Report* 1982, chap. 5); Australia, Treasury (1982); Anderson (1983, chap. 5); Sexton and Adamovitch (1981, chaps. 6 to 10); and Harvey (1981, chaps. 2 to 4).

5 In the last four years of the 1970s it took on average about 20 days to settle takeovers without conditions, 23 days when approval was conditional, and about 40 days when takeovers were rejected. For new businesses, where maximum times are not set, the averages were about 33, 42, and 70 days respectively. In 1981-2 and 1982-3, about three-quarters of all cases were resolved within 30 days. Many such cases were relatively routine real estate transactions. It is important to note that preliminary consultation before formal notice, which is common, would tend to reduce these times (Sexton and Adamovich 1981, 99, 117, and 124; and Australia *FIRB Report* 1982, 1-4, and 1983, 3).

6 What must be reported, and may be reviewed, is a 15 per cent or larger ownership of voting stock by a single foreign interest or associated interests, or 40 per cent for two or more non-associated interests.

7 The FIRA's treatment of third-party intervention by potential buyers and others is outlined in Schultz et al. (1980, 67-71).

8 An officer of the FIRB began a long statement on this point as follows:

> The short answer is that FIRB does not act as any kind of arbiter at all between competing bids. That is not to say that FIRB takes no account of views put before it by those who wish to do so. (Harvey 1981, 188)

9 The one exception is the relatively small number of undertakings, outside real estate, which required resale of assets if the other basic conditions attached to a proposal could not be met (Australia, FIRB 1983, 7).

10 Sexton and Adamovich (1981, 116) state that:

> At present there is no regular monitoring of corporations that have agreed to carry out conditions over a period of time. . . . The result is that only major cases, or those cases where a problem comes to notice, are investigated for breaches of the conditions of approval.

They go on to note that many conditions are longer term and would not be in breach at that date.

11 The OECD guidelines, let it be noted, are voluntary and reflect in their highly qualified wording the different viewpoints of home and host countries, MNEs, and trade unions.

12 The handling of the Oaky Creek coking coal project and the Blair Athol steam coal project, both in Queensland, are cases in point. See *The Economist*, 11 April 1980, 74.

13 Based on Reserve Bank of Australia (1980, 14) and interviews with Reserve Bank and Treasury officials.

14 The rejection rate rose from 5 per cent to 10 per cent during 1982-3 after the election of the new government. The FIRB (Australia 1983,6) suggests that this increase was partly fortuitous rather than simply the result of a change in policy. However, the Treasurer's statement of December 1983 indicated that henceforth all proposals would have to show significant economic benefits or Australian equity, not just proposals in sectors where foreign ownership was high or would become so because of the proposal. If implemented fully, this measure will raise the rejection rate.

15 The outcome of the review was reported in a statement by the Treasurer, Mr. Paul Keating, 20 December 1983. The quotations are from pages 1, 2, and 10 of that statement.

16 The commercial banking systems of both countries are highly concentrated: in each case, four or five banks account for 85 to 90 per cent of the total assets. For details of the changes proposed, see the statement by the Treasurer, Mr. Paul Keating, 10 September 1984; *The Economist*, 3 February 1985, 75; and the *Globe and Mail* 17 September 1984, 11 February 1985, and 28 February 1985.

17 Statements by the Treasurer, Mr. Paul Keating, 18 April and 18 December 1984.

18 What follows is by way of example only. Canada, FIRA, Parts I and II (1977) contains a detailed statement of legislation, to which one should add particularly the legislation relating to the NEP. For analyses of the FIRA or the NEP, see Anderson (1984, chaps. 3 and 7); Harvey (1981, chaps. 2-4); Conference Board of Canada (1984); Globerman (1979, 1984b); Safarian (1983a, b, and c); Schultz et al. (1980); the annual reports of the FIRA; and Canada, FIRA (1979).

19 For taxation issues related to FDI, see Brean (1984). The FIRA's procedures are discussed in considerable detail in Harvey (1981, chap. 3) and Schultz et al. (1980, chap. 2).

20 It is important to note that in the late 1970s about 55 per cent of cases involving small businesses went to the Special Committee of Council, made up of members of the cabinet, and that another 20 per cent could go there if a consulted province or federal department did not object (Schultz et al. 1980, 73-6). In the early 1980s there were further extensions of ministerial review in cases in which no province or department objected.

21 The definition of foreign ownership used in Table 2 yields much higher percentages for Canadian ownership, since it takes into account factors such as reserves, transmission, and distribution where the latter is higher, and capital invested rather than revenues.

22 In the early 1980s, the FIRA has a staff of 130, of whom half were professional and technical personnel; the comparable figures for the FIRB are 50 and 35. The tasks involved were different, however, as noted in the text.

23 There was no requirement that the minister publish the letters, but in some cases the undertakings were published in detail. Examples are given in Safarian (1983a, 97-104). For a further analysis of 'performance requirements', see Safarian (1983b). It is of interest to note that, while the FIRB publishes a tabular summary of the 'benefits' stated by the firms and used in the assessment, the FIRA publishes them by company for all allowed cases by ten categories.

24 See Safarian (1978), Schultz et al. (1980), and Harvey (1981, especially 163-71). Harvey notes several unsuccessful attempts by the FIRA to clarify its mandate. His list of factors emphasized in negotiations demonstrates this lack of clarity, since it raises more questions than it answers. Is it literally true, for example, that the FIRA begins with the position that investors are 'not wanted if they would merely duplicate an existing business' (167)?

25 These are fiscal years. See Globerman (1984a) for a more detailed analysis of the variability of the Canadian rate.

26 There were variations in position among the parties, notably in the treatment of uranium. Anderson (1984, 94-5 and 104) argues that mid-1979 'was a critical, switch-over point in terms of FIRB's

operating philosophy' in that all 27 new projects approved in the three subsequent years either met the 50 per cent rule or were required to meet it before commercial production began. This is clearly different from the data given above on the earlier record. However, it is not clear that all projects after 1979 did meet the rule before production began.

27 See Anderson (1984, 4-5, 42, and 46-7) on the rather uncertain status of the 1974 announcement. The Anderson study's primary focus is on the effects of applying such an approach to Canada.

28 Forty-five days with another 30 possible, and more if the applicant agrees. It is difficult to see how applicants could refuse to agree in practice. See Lucas (1985) for a comment on the uncertainty and possible conflicts of interest that could remain with the new legislation.

29 The Australian resource rent tax, which is an attempt to get around this problem, is noted below.

30 For a comparison of the Australian and Canadian experiences, emphasizing the problems in regulating direct investment in federal states, see Stevenson (1976). He argues that the two countries' sequence of policy development was the same but Canada's took longer because of greater regional differences.

31 These are the sectors as defined by Statistics Canada, rather than those of the Corporation and Labour Unions Returns Act.

32 Safarian (1983a, 96). Changes in the share of inward stock of direct investment were about the same up to 1978, probably because this factor adjusts more slowly than do flows.

33 For a review and extensions of the theoretical literature, see Caves (1982) and Rugman (1982). Some of the more recent studies include McKern (1976, chaps. 2, 9, and 10), Vernon and Davidson (1979), Davidson and McFetridge (1984), and Mansfield and Romeo (1980). A number of additional studies are outlined in Caves (1982).

34 MNEs appear to have made more transfers outside subsidiaries since about 1970. There are many reasons for this shift apart from those noted in the text; for example, more readiness to joint venture in a world of increased uncertainty in order to reduce risk and gain access to other MNE technologies, and government preferences for non-control forms of transfer. Whether the MNE form as such is diminishing is not clear. See OECD (1984).

35 See Caves (1982, 198-200) for an analysis of the degree to which R&D is centralized and the conditions that determine its decentralization to subsidiaries; Safarian (1966, chap. 4) for a discussion of the comparable issues in connection with export allocation and performance; and Safarian (1983b) for an analysis of trade-related performance requirements. Note also that this issue is different from that of the performance of R&D and of exports by subsidiaries relative to independent firms in Canada, on which a comment is made in Chapter 5 of this study.

36 The 50 per cent rule extends to voting strength on the board of the project. However, there is no requirement that the Australian 50 per cent be a joint venture partner or partners, so the foreign-owned firm can retain effective control for most purposes. The FIRB may require dilution of MNE ownership of the main subsidiary in particular cases as the price of a 100 per cent takeover of a domestic firm.

37 One observer estimated that Australian ownership of mining industry assets would rise to 53 per cent by June 1985 from 47 per cent in 1979-80. The Australian ownership of major newer projects is estimated at 56 per cent. Cited by Anderson (1984, 100-101) from a study by Bruce McKern.

38 The effects of the Australian policy on the distribution of the gains are considered more fully in McKern (1976, chap. 10) and Anderson (1984, 108-18). Parry (1983, 25-30) has also criticized this and other aspects of the policy on local equity.

39 McKern (1976, 13, 22, and 186) notes that in the early 1960s Australia had only three firms that could undertake major mining projects, and that none of the Australian-owned participants in minerals in the mid-1970s was an MNE, given a definition of an MNE as a firm that operates in seven or more countries and whose foreign source income is 25 per cent of its total income.

40 A resource rent tax is essentially a profits tax that is collected when a given rate of return is realized, and that can be raised progressively as higher rates of return are realized. See Garnaut and Ross (1978, 1983), and also Australia (1984) and *Economist*, 4 February 1984, 72-3.

41 An example of the type of jockeying that goes on is provided by a report in *The Financial Australian* (22 June 1981, 13) that Japanese steel mills decided to reconsider plans for a new iron ore

mine after the West Australian minister for Mines and Energy met their officials to clarify the foreign investment guidelines. 'Canberra statements have left an impression here that any new project will have to have 50 per cent Australian equity', he is quoted as saying. 'If this was an obstacle to their decision-making, I have been able to correct it.'

42 If the state governments and firms are prepared to go ahead with the projects, the effect of this control may be simply to shift emphasis to private borrowing abroad.

43 See Table 9. These short-term effects, and other aspects of the NEP, are discussed more fully in Safarian (1983c).

44 Details about this concept are available in Safarian (1983a) and especially in the various OECD documents cited there.

45 It should be added that there is considerable pressure within the Australian Labour Party for stronger policies, but the point is that this view has not prevailed to date.

46 For example, there was the assertion that future mining would be 100 per cent Australian-owned, as reflected in Labour Party policy at the time; the mysterious attempt to borrow large amounts abroad for unkown purposes, but presumed by some to be for purchase of firms; and the attempt to set up a government authority to participate in exploration. See *The Economist*, 27 March 1976, Survey, 4, 7, 20, and 25; and Arndt (1977) for other examples.

47 The NDP took a stronger stand on MNE issues than either the Liberal Party or the Conservative Party in the 1970s, although its position was often indistinguishable from that of many Ontario members of the federal Liberal Party. It has been argued that the FIRA was probably stronger than originally planned by the then Liberal government, in part as the price for NDP support of a minority government. The legislation introduced before the election of 1972 covered takeovers only, a move criticized by the NDP. The minority Liberal government after the election introduced a more comprehensive bill. See Fayerweather (1973, 163-5) and C. McMillan as quoted in Harvey (1981, 35).

48 The contrast between the FIRB and the FIRA on this point can be underlined by noting the comment made by an official of the former agency during an inteview in 1981. He stated that specific conditions (on exports and local research in manufacturing sectors) were not required, since the firms would undertake these

if they made commercial sense and, if they did not, the government should not impose such conditions. Canadian officials, in the appeal to GATT on the FIRA and elsewhere, have emphasized the need for corrections to the distortions in markets resulting from the decisions of large oligopolistic firms.

49 Chapter 4 of this Australian Treasury study deals with micro-economic effects. Its findings in this regard are in contrast to those of the Gray Report in Canada, which appeared at about the same time, and which the Australian study cites.

50 Parry and Watson conclude, among other things, that a large proportion of the sample subsidiaries conducted R&D within the Australian enterprise, that some of these resources went to modifying overseas technology, that restrictions on exports were significant but much less so than in the case of technology agreements with non-affiliates, and that subsidiaries' exports of technology were significant. Comparable data for lcoally owned firms were not collected, however.

51 See Australia (1977) and Australia (1979).

52 See, for example, Crough and Wheelwright (1981) and a number of other publications of the Transnational Corporations Research Project, University of Sydney, Canberra.

53 See Harvey (1981, 37-40) on the positions of senior officials in the two countries. The phrasing on policy insulation is from Sexton and Adamovich (1981, 198). Several officials that I interviewed outside Treasury took a similar view of the Australian situation.

54 For an attempt to evaluate the various economic and political effects of FDI and MNEs in Canada, see Safarian (1985a).

55 Anderson (1984, chap.8) presents a case for an Australian-type approach to the primary resources sector, partly on the grounds that a fixed-rules approach is more appropriate there than the bargaining approach of a review agency.

56 Safarian (1985a) has a fuller discussion of this point, along with references to the relevant literature. The treatment of competing domestic bids for takeovers, outlined on pp. 15-16 above and Schultz et al. (1980, 67-71), is one example of the potential for creating rents for private firms. Whether the rents are captured by domestic owners in practice depends on many variables, as our discussion of Australian and Canadian resource policies suggested.

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